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GENERAL DISCUSSION OF INTERNATIONAL ECONOMIC AND SOCIAL POLICY, INCLUDING REGIONAL AND SECTORAL DEVELOPMENTS

Role of the public sector in promoting the economic development of developing countries

Report of the Secretary-General

CONTENTS

* A/42/50.

** See Economic and Social Council decision 1987/108.

I. INTRODUCTION

1. This is the third comprehensive report of the Secretary-General on the role of the public sector in promoting the economic development of developing countries submitted to the General Assembly, through the Economic and Social Council, at the request of the Council. In its resolution 1983/61 of 28 July 1983, the Economic and Social Council took note of the second comprehensive report (A/38/176-E/1983/50) and invited the Secretary-General to submit, through the Council, a further comprehensive report to the General Assembly at its forty-second session, paying special attention to the provisions of paragraph 5 of General Assembly resolution 34/137: the role of the public sector in the mobilization of national resources for economic and social development; the role of public enterprises as the main instruments of the public sector and ways of increasing their efficacy; the role of the public sector as a lever for introducing national development plans and establishing social and economic development priorities; and the role of the public sector in relation to other sectors of economic activity. Emphasis was also to be placed on ways of strengthening the public sector as a basis for developing national and international measures and to ways of facilitating the exchange of experience and information on the role of the public sector within developing countries.

2. The Economic and Social Council, in its resolution 1983/61, requested that a seminar on the role of the public sector in promoting the economic development of developing countries be organized in close co-operation with competent bodies and organizations of the United Nations system. Accordingly, the Secretary-General convened an interregional seminar on the role of the public sector in the mobilization of domestic financial resources for economic and social development of developing countries at Bangkok from 3 to 7 December 1985.

3. The present report deals with those aspects of the role of the public sector specified by the General Assembly in resolution 34/137, as noted in paragraph 1 above.

II. NATIONAL ECONOMIC FRAMEWORK: STRUCTURAL ADJUSTMENT, PLANNING, REGULATION AND PROMOTION

4. In the past four years, the rates of growth in most developing countries have not been high enough to offset population growth, let alone produce per capita development gains. The emergency situation in Africa dramatizes the urgent development needs and unsatisfactory growth performance of that region. In a number of developing countries in Asia, positive growth rates have been achieved. However, while this represents an encouraging development it has to be set against the persistent absolute poverty of millions of people. In Latin America, while the availability of loanable funds has eased financial strains, debt servicing has been associated with a deterioration of living standards, increases in unemployment, compression of imports and an acceleration of inflation. Although recent multi-year rescheduling arrangements have provided some accomodation, the burden of debt service payments remains onerous, especially in reduced external financial

flows. These developments have had a strong impact on many developing countries, impairing their prospects for economic recovery and progress in achieving self-sustaining growth, and emphasizing the urgent need for improving national economic management.

A. Structural adjustment and the public sector

5. In spite of limited national resources, lower export earnings, lower capital inflows and corresponding budget constraints, most developing countries have tried to maintain a level of public sector services. While overall public sector expenditures continued to increase in real terms until 1983, since then the rate of increase in government spending on major social services, including education, health, amenities and housing, has fallen below the level needed to maintain the status quo, given prevailing demographic patterns and growth. Real spending since 1983 has fallen in Africa and Latin America, although modest increases were recorded in Asia. In a large number of developing countries, major public sector investment programmes, particularly infrastructure projects, were curtailed, postponed or abandoned. Similarly, public employment, salaries and subsidies were reduced.

6. Against this background, many countries have introduced major stabilization and adjustment programmes aimed at bringing about changes in the level and composition of investment and in its financing from domestic and external sources. Given the complex set of issues involved, discussion on adjustment in general and its impact on macro-economic policies reveal a wide scope for disagreement, particularly with respect to the appropriate mix of public and private sector roles in promoting development. There is an increasing perception that, in any growth strategy or adjustment programme, there must be a balance between the provision of public goods, social services and human infrastructure, on the one hand, and the production of private goods and services, on the other. There is no purely technical way to decide on these matters which are essentially questions of public choice, public discussion and sovereign decision.

7. In many countries, economic difficulties, including budgetary constraints, have not only called for adjustment programmes, emphasizing greater efficiency in public sector management, but have also given impetus to the search for ways in which all the resources of society can be brought into play to promote faster growth, employment and common welfare. As a consequence, a revision has been under way of the interaction of the public and other sectors.

B. National economic management

8. A major challenge facing developing countries is the degree of adjustment they need to make. To restore their balance of payments, developing countries need to make structural adjustments to raise exports in relation to imports with substantial reductions in spending and investments. While part of the cuts in government expenditures may be obtained from reduced public sector investment

programmes, attempts have also been made to adjust macro-economic management policies to accommodate changing domestic and international circumstances.

9. During the 1970s, many developing countries utilized increased levels of export earnings to finance ambitious public investment programmes. As demand for exports tapered off and their terms of trade deteriorated, budgetary receipts started to lag behind the growth in expenditures and budgetary deficits increased. These deficits were increasingly financed by domestic and external borrowing. The expansion of credit to the public sector increased the pressure on domestic prices and the balance of payments, entailing growing distortions in the economies and slowing down of economic activity.

10. With the global economic recession in the early 1980s, government revenues have been drastically reduced, forcing cutbacks in both recurrent and investment expenditures. For the group of developing countries as a whole, the share of output spent on investment has fallen from some 26 per cent of the gross domestic product in 1981 to 23 per cent in 1983. Reductions were particularly severe in the Latin American countries. In Brazil, for example, the ratio of investment to the gross domestic product averaged 28 per cent during the 1973-1978 period and fell to 22.5 per cent between 1979 and 1983. Comparable figures for Argentina were 24.6 per cent and 20.5 per cent. 1/

11. Economic constraints required most countries to implement policies which stressed efficiency in public sector management, rationalization of existing regulations and controls and, where applicable, the provision of incentives to private initiative. For example, the Economic Report on Africa, 1984, issued jointly by the African Development Bank and the Economic Commission for Africa, stated: "Necessary conditions for growth are the improvement of the management of national economies, deep reforms in the public sector, as well as the provision of sufficient incentives to private initiative." 2/ In attempting to attain those objectives, many countries have fallen back on planning and budgeting as instruments for improved management performance and more efficient allocation of public resources.

C. Planning

12. For a long time planning represented a major instrument for directing economic activity and providing medium- and long-term perspectives on development. National development plans have mostly emphasized physical and quantitative targets to be attained over the medium- and long-term period. However, when they failed to show the needed resilience and flexibility to respond to short-term uncertainty and changes resulting from recent dislocations in the world economy, their usefulness was reduced. In Asia, many countries allowed their planning process to lose importance and relied on annual budgets. In Latin America, there was a growing perception that medium-term planning had little influence on either public sector investments or economic policy. In Africa, formal planning efforts were constrained as the attention of most Governments was pre-empted by demands of short-term crisis management.

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13. The need for structural adjustment programmes to restore sustained growth, calling for short-term policies implementation while at the same time devising medium- and long-term development strategies, compelled most developing countries to conceive planning systems with renewed institutions, processes and methods. Given the current uncertainties, it is only within a comprehensive planning system that account is likely to be taken of the implications of the short and longer term evolution of the economy in general and the public sector in particular. This system, emphasizing the rationalization of the current macro-economic framework and incorporating multiple objectives which cannot readily be traded off against each other, must be flexible and capable of rapid adaptation to the sudden changes that can affect domestic or external circumstances.

14. Within such a framework the planning process is at the same time more strategic and operational. While strategic planning is concerned with major policy decisions, choices and priorities, operational planning concentrates on policies implementation and economic information gathering. In specific terms, strategic planning involves regular tasks of surveying trends in the national and international economies to identify constraints on macro-economic performance and opportunities as they emerge. Operational planning, on the other hand, relates to a series of tasks involving the management of development budget, the processing of projects, the ongoing work required for adjustments in agricultural prices, the collection and presentation of economic performance and the like. Both planning functions promote closer integration of the structural objectives, which are usually of medium- to long-term effect, with decisions involving macro-economic policy measures, which are inherently of a short-term nature.

15. A major objective of planning can be divided between efforts to improve the effectiveness of public investment and spending, and the use of a wide range of other policy instruments to influence the direction, level and efficiency of economic activity by other sectors. In many respects, the planning task as regards public investment spending is recognized to be a central concern to planning. Although the context of structural adjustment and the recognition of the importance of the incentive structure may suggest that public sector investment budget is of less dominant importance than appeared in the past, the public investment programme still represents an important concern for planning.

16. Many developing countries experiencing fiscal retrenchment have adopted planning techniques that integrate short-term efforts to keep under review public expenditures with long-term requirements for revenue increase and public expenditure expansion at levels which meet the needs for essential public services. The tendency for investment budgets to be pared down to the highest priority ongoing projects has also been tempered by innovative planning techniques giving attention to the investment programming requirements of longer term structural adjustments. In Burma, for example, the need to tailor public expenditures to constrained financial resources compelled the Government to review public investment priorities for the Five-Year Plan to adhere to an approach emphasizing (a) continued support to high potential areas in agriculture; (b) repair and rehabilitation of old plant and equipment; and (c) selective investment capacity expansion in agro-processing, manufacturing and transport. This approach is intended to concentrate the use of resources on the early

completion of large investments where the costs to the public sector of delays would be detrimental, while at the same time promoting new projects with high and early economic returns which would help strengthen the productive and export capabilities. Similarly, in Somalia, under the 1982-1986 development plan, the central objective of the public investment programme is to channel available financial resources to their highest priority uses, namely, development activities with the greatest promise for augmenting immediate domestic commodity production, increasing exports, replacing imports and generating domestic revenues.

17. In all aspects of economic management, and particularly development planning, good information and forecasting systems are essential. While the collection, dissemination and analysis of economic information enable planners to adapt swiftly plan implementation to changes that occur in the international or domestic situation, forecasting systems facilitate the study of alternative strategies in the light of a number of different assumptions about the future of the international system. Experience in many developing countries has shown that by using appropriate information and macro-economic planning systems, it was possible to conduct reliable monitoring of the economy and, on that basis, provide permanent forecasting of the major macro-economic parameters. This approach enabled many of the countries to identify, at an early stage, economic imbalances and undertake appropriate corrective actions.

18. Improved information systems have greatly contributed to strengthening the planning capacities in many developing countries. For example, the export-oriented strategy in Brazil was greatly aided by comprehensive and up-to-date statistics on foreign trade. In India, the recent centralization of information on the movement of railway wagons has helped to improve the railway's efficiency, with spin-off benefits from such public sector industries as coal and fertilizers. In Morocco, the introduction of mandatory co-ordination between financial policy and development planning has enabled the Government to implement annual plans narrowing the budget and current account deficits. In Kenya, improved data on food production and crop forecasts helped authorities in planning and organizing the distribution of supplies to the drought-stricken areas.

D. Budgeting

19. In an atmosphere of uncertainty and change, management of public resources in the short-term assumes critical importance. The extraordinary pace of growth of public expenditures coupled with the need for greater efficiency in national resource allocation led many countries to introduce multi-year budgeting with a view to improving the planning process. This approach required systems of budgeting that would enable forecasting long-term planning implications, while at the same time providing information on short-term planning performance.

20. To meet these requirements a large number of countries have introduced programme budgeting systems which provide a useful framework for public expenditures rationalization and effective budgeting attempts, on the one hand, to classify planning activities in terms of functions, sectors, programmes and projects and, on the other, to develop units of measurement for the evaluation of

performance. In many instances the co-ordination of programme budgeting with the planning process has enabled Governments to avoid the negative effects of across the board cuts and preserve a core-investment programme of priority projects. Similarly, the implementation of a programme budgeting system has enabled some countries to assess more precisely and meet the requirements of recurrent cost of planned public investment programmes. For example, in Botswana, the national development plan includes the projections of the recurrent budget costs arising from each project in the public investment programme. These costs are consolidated into revenue and expenditure projections over a three-year time frame.

E. Regulation and promotion

21. Since the beginning of the current decade, there has been a marked change towards rationalization and liberalization in the regulatory framework and policies of most developing countries. This change is gaining increased momentum, reflecting the view that while the public sector has a vital role to play in economic development, its activities can be made more dynamic if concentrated in critical areas and oriented towards providing impetus in achieving improved economic performance.

22. In most developing countries, the regulatory framework, consisting of control and promotional measures, is aimed at contributing to economic efficiency in its broadest sense, including encouraging economic initiative while reducing unfair business practices, keeping prices in line with costs, promoting technological change for cost-reduction purposes and improving consumer knowledge of product quality. Recent evidence in some of these countries has shown that cumbersome and excessive regulatory procedures have resulted in rapid expansion of the bureaucracy, severely straining the public budget, causing problems in labour relations within the public sector, inefficiency in government and adverse effects on the whole economy. These problems have led many countries to undertake major reviews of their regulatory framework which, in some instances, involve deregulation of certain markets, liberalization of some activities and privatization of selective enterprises.

23. The current policies of many developing countries may illustrate this trend. For example, the Governments of Brazil, Colombia, India, Kenya, Morocco and other countries intend to rationalize and simplify the operation of their countries' rapidly expanding capital markets to provide for an increased capital mobilization and industrial expansion and change. These countries are also in the process of rationalizing their tax system in order, *inter alia*, to encourage public and private sector investments. Policies in these countries have also been introduced for opening up domestic industry for increased foreign collaboration and facilitate the flow and assimilation of foreign ideas and techniques.

III. MOBILIZATION OF NATIONAL RESOURCES

24. The public sector mobilizes resources in three principal ways: first, by raising revenue through taxation and charging for services; second, by borrowing from residents and non-residents; and third, by introducing measures to promote savings in the non-government sectors of the economy. The public sector also mobilizes labour directly in local public and community development works.

A. Government revenue

25. The most comprehensive indicator of the importance of government revenue in an economy relates all revenues of the public sector (taxes, fees and charges levied by central, state and local governments) to a measure of national income, such as gross domestic or gross national product. Such an indicator is difficult to compute because of incomplete statistics. Nevertheless, in table 2 we show a comparison between current central government revenue and gross national product.

26. Of the 56 countries listed in table 1, only five had a ratio of less than 10 per cent; 17 fell in the range of 10-19 per cent; 25 were in the range of 20-29 per cent and for the remaining nine, central government current revenue was 30 per cent or more of the gross national product. Of the large number of factors affecting a government's ability to raise taxes, the level of well-being of the people is particularly important. Hence it follows that the poorest countries will face the greatest difficulty in raising taxation as evident in the relationship of the central government current revenue as a percentage of gross national product (shown in parentheses) for five groups of countries extracted from table 1: low-income economies (13.6); lower middle-income economies (20.9); middle-income economies (23.1); upper middle-income economies (24.1); and industrial economies (27.0). However, there are exceptions to this relationship. Surprisingly, Mali and Togo, which are classified as low-income economies, raise the equivalent of 29 per cent of gross national product in central government current taxation, while Guinea, Kenya, Malawi, Sri Lanka and Zaire, in the same classification, achieve 20 per cent or more. On the other hand, in the upper middle-income group, Argentina, the Islamic Republic of Iran and Uruguay did not reach the 10 per cent level.

27. Generally, one would suppose that those countries with the lowest ratio between government tax revenue and gross national product would have the greatest potential for increased taxation, particularly those with a high gross national product per capita. However, there are a large number of other influential factors. The factors which permit and promote efforts to increase taxation are: a relatively open economy (imports and exports are more easily identified and taxed than internal domestic transactions); a government which commands the respect of taxpayers in its handling of public money; tax structures which recognize the principle of ability to pay; methods of paying taxation which are adapted to the needs and habits of the people; efficient, honest and well-trained tax staff; systems of taxation which are understood by those who are taxed; and efficient related administrative systems (e.g., postal, police, business registration and judicial systems; and good accounting and documentary evidence for transactions).

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Table 1. Central government current revenue as a percentage of the gross national product in 56 developing countries (1983)

Below 10 per cent	10-19 per cent	20-29 per cent	30 per cent and above
Bolivia	Argentina	Brazil	Botswana
Ghana	Burkina Faso	Cameroon	Chile
Nepal	Burma	Costa Rica	Egypt
Sierra Leone	Dominican Republic	Guinea	Israel
Uganda	Ecuador	Indonesia	Nicaragua
	El Salvador	Iran (Islamic Republic of)	Panama
	Guatemala	Jordan	Singapore
	Haiti	Kenya	Tunisia
	India	Lesotho	Zimbabwe
	Madagascar	Liberia	
	Pakistan	Malawi	
	Paraguay	Mali	
	Peru	Mauritius	
	Philippines	Mexico	
	Republic of Korea	Morocco	
	Sudan	Papua New Guinea	
	Thailand	Senegal	
		Sri Lanka	
		Togo	
		Turkey	
		Uruguay	
		Venezuela	
		Yemen	
		Zaire	
		Zambia	

Source: World Bank, World Development Report, 1986, table 23, excluding high income oil exporters and 30 developing countries for which no details were available. Note that local taxation is not reflected in the above figures. In the cases of Bolivia, Brazil and Pakistan, such taxation is significant.

Table 2. Sources of revenue as a percentage of central government current revenue for four groups of countries

	Source of revenue					
	Tax revenue				Non-tax revenue	Total
	Income profit capital gain	Domestic goods and services	International trade	Other revenue		
Low-income countries	17.7	37.5	26.7	1.4	16.7	100
Middle-income countries	27.4	26.5	10.4	12.2	23.5	100
Upper middle-income countries	35.8 a/	27.7	8.9	1.4	26.2	100
Industrialized countries	70.4 a/	18.1	1.2	0.9	9.4	100

Source: World Bank, World Development Report, 1986, table 23, excluding high income oil exporters and 30 developing countries for which no details were available. Note that local taxation is not reflected in the above figures. In the cases of Bolivia, Brazil and Pakistan, such taxation is significant.

a/ Including social security contributions.

The factors which prevent increases in taxation are generally the reverse of these. In addition, one should mention that sudden and significant increases in the burden of taxation are frequently politically unacceptable, except when the proceeds are used to counter an external threat such as war.

28. In mobilizing resources for the public sector, substantial differences exist among countries in the instruments used. Table 2 shows the sources which contribute to central government current revenue, as a percentage, for four groups of countries: the first three columns of the table tell a very clear tale. The poorer a country is, the more it relies on indirect taxation; the richer a country is, the more it relies on direct taxation. Moreover, taxation of international trade represents a significant source of government revenue for poor countries, but a negligible one for rich countries.

29. Again, there are a number of exceptions. For example, amongst low-income countries, Malawi, Togo and Zaire raise more than 30 per cent of government revenue from direct taxation, while Guinea and Sudan raise less than 15 per cent from taxes

on domestic goods and services. Amongst middle income countries, Cameroon, Ecuador, Indonesia, Papua New Guinea, Turkey and Zimbabwe raise more than 40 per cent of central government revenue from direct taxes.

B. Borrowing

30. A surplus or deficit in the government budget is defined as revenue plus grants less expenditure. Expenditure includes current and capital items, transfer payments and net lending by the government (e.g., loans to public enterprises less repayments of these loans). During the period 1979-1984, government budgetary deficits grew, world-wide, even amongst oil exporters. Several countries tended to have persistent budget deficits. During the period 1978-1984, the average deficit for developing countries was 15.7 per cent. Many countries greatly exceeded this figure as shown in table 3.

Table 3. Developing countries with deficits in central government budgets a/ in excess of 20 per cent, during the period 1978-1984 b/

20-29 per cent	30-39 per cent	40 per cent and above
Argentina	Guyana (1978-1982)	Bolivia (1982 omitted)
Egypt (1980 omitted)	India	Ghana
El Salvador	Jamaica (1978-1981)	Sierra Leone
Gambia (1978-1982)	Maldives (1979-1984)	United Republic of Tanzania (1978-1981)
Guatemala (1978-1983)	Mauritius	Yemen
Iran (Islamic Republic of)	Nicaragua (1978-1983)	
Israel	Sri Lanka	
Jordan	Uganda	
Kenya	Zambia	
Liberia		
Malawi		
Malaysia (1978-1981)		
Mali (1978-1983)		
Mexico		
Morocco		
Nepal		
Pakistan		
Panama (1978-1982)		
Thailand		
Zimbabwe		

Source: International Monetary Fund, *Government Finance Statistics Yearbook*, 1986, pp. 38-39.

a/ Deficit in government budget is expressed as a percentage of total government expenditure (including central government on-lending less repayments).

b/ Figures given are for the period 1978-1984 unless otherwise shown.

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31. When expenditure exceeds income, the resultant deficit has to be financed by borrowing; the larger the deficit, the greater the difficulty in financing it and the larger will be the secondary economic effects. Clearly, some of the countries shown in table 3 are running excessive budget deficits, which, if continued, imply severe adjustment problems. Governments can finance budgetary deficits by either external or domestic borrowing. The costs of servicing external public debt can be expressed as a percentage of exports of goods and services. The statistical data available for 65 developing countries for 1986 indicate that the cost of servicing external public debt as a percentage of exports of goods and services was 0-9 per cent for 15 countries, 10-19 per cent for 23 countries, 20-29 per cent for 20 countries, and 30 per cent or more for 7 countries. 3/ Clearly, those countries with high percentages have to work very hard to generate foreign currency to finance public sector borrowing, leaving very little available to finance imports.

32. One consequence of domestic borrowing is that the Government may become the single largest debtor in the banking system. This is indeed the situation in many countries. Thus, in 10 of 72 developing countries in 1980 for which data were available, more than half the assets in the banking system were claims on government. In 11, the proportion was one third or more. One consequence of this situation is to crowd the private sector out of the credit market.

33. Another tendency is for some governments to keep interest rates artificially low. This saves the government money because it reduces interest on the government debt. It also appears to favour borrowing in other sectors, because the low cost of credit is an incentive to invest. However, low interest rates may not provide sufficient inducement for savers to save, or at least to channel their funds through organized capital markets. The result is that the amount of resources mobilized is small. This is particularly the case when low interest rates are accompanied by high rates of inflation. Then the real rate of return is negative and there is a positive disincentive to make money available through organized capital markets. Indeed, when the rate of inflation is high enough, it results in a flight from the domestic currency into valuable metals, strategic materials and property, and the export of capital either officially or clandestinely.

34. The first half of the 1980s marked a significant turning point in the availability of external financing to developing countries. Two decades of flexible access to external credit had created better trading conditions and faster capital formation. However, increasing difficulties in servicing larger and larger external liabilities, combined with the vulnerability of the international banking system to bad debts, created the conditions for an abrupt contraction of external credit. The only option for heavily indebted developing countries, in the absence of positive changes in the external environment, was far-reaching economic readjustment. It is interesting to note that of 94 structural adjustment programmes reported on by the International Monetary Fund in 1986, more than half contained measures to mobilize domestic savings and to improve or reform tax administration.

C. Promoting domestic savings

35. The basic role of the government is to create favourable conditions for the mobilization of savings throughout the economy. Savings typically occur in a large number of small quantities. A mechanism is needed for channelling these savings and mobilizing them for productive use, i.e., collecting them into more manageable lumps and making them available for those needing credit to finance economic activity. Generally, developing countries lack the sophisticated means available in richer countries to accomplish this task. Banks and provident institutions have often been opened in large towns and commercial centres, leaving the large agricultural hinterland poorly provided. In this sector, savers resort to traditional means of saving, e.g., currency, precious metals, cattle and land, if they are rich enough. Some economic activity is financed by primitive credit rotation methods, such as Chilemba (East Africa), Chit (India), Gameya (Egypt), Tontine (Senegal) and Susu Unions (Trinidad and Tobago). On the whole, however, there is a dearth of available credit.

36. Problems exist in extending savings institutions to rural areas. First, banks tend not to locate in rural areas because of the high costs of start-up and the low expected returns. Second, rural banks may become the means of channelling savings out of the rural areas for lending in urban areas, thus further impoverishing the agricultural sector. Third, rural areas may have a high level of illiteracy and lack of familiarity with banks and financial assets. Fourth, the rural borrower may not have the type of assets traditionally required by bankers as security for a loan. Fifth, because of the pattern of saving and harvesting and because of poverty, small farmers often need short-term credit to cover family consumption expenditure as well as farming expenses.

37. The special problems posed by resource mobilization in the rural sector call for special solutions. Many countries have done innovative work in this area, for example, Cuba (Banco Popular de Ahorro), Bangladesh (Grameen Bank), India (regional rural banks), China (rural credit co-operatives), Pakistan (supervised agricultural credit scheme), the Republic of Korea (mutual financing programme) and the Philippines (cash bond programme). Some of the solutions adopted are as follows: direction of banks into certain areas of the country, loan-linked savings schemes, special banking procedures for illiterate customers, evolution of new banking standards for taking of security (e.g., treatment of cattle as collateral in Swaziland) and insurance schemes to reduce credit risk and to guarantee depositors.

38. Such innovations do not apply only to the rural sector. In their efforts to increase the level and to diversify the composition of savings, governments have used some of the methods mentioned above, but have also encouraged savings at the work-place, contractual savings schemes, deposit collectors working as agents of savings institutions, savings schemes intended to imbue children with the saving habit, and provident and mutual funds. Some of the methods described above have been with tax incentives.

39. Finally, we may note that for savings to grow the conditions have to be right. Empirical work on the responsiveness of the level of savings to real interest rates is inconclusive. However, it seems that savers are unlikely to

invest in financial assets unless they can expect a reasonable return allowing for inflation. Countries with rapid rates of inflation have indexed interest rates or capital sums to achieve this result.

D. Community development and public works programmes

40. The public sector plays a role in the mobilization of resources by the employment of otherwise idle labour in public works and community development projects. Such projects have been successfully carried out in many developing countries, including Bangladesh, Egypt, India and Kenya. In many developing countries where seasonal unemployment persists to varying degrees, the public sector has endeavoured to provide purchasing power to rural families and to mobilize their labour in building roads, irrigation facilities and other infrastructure projects that can raise productivity. Since many of these projects are small and less complex, the demand on scarce resources of skilled labour and other capital is minimum. At the same time, this limits the potential of this means of mobilizing resources to small projects of local interest.

IV. PUBLIC ENTERPRISES AS THE MAIN INSTRUMENTS OF THE PUBLIC SECTOR

A. Role and significance of public enterprises

1. Universal spread of public enterprises

41. As instruments of public policy, public enterprises are now almost universal. Apart from their common use in centrally planned economies, they are widely used as such instruments in both developed and developing market economy countries. This is true of Africa, Western Asia, Latin America and the Asia and Pacific regions.

42. Public enterprises are present within the major economic sectors in developing countries. They are most common for utilities, in transport and in manufacturing. In mining, public enterprises are especially important in such countries as Brazil, Guyana, India, Iraq and Zambia. In manufacturing, they dominate in Iraq, Jordan, Morocco and the Syrian Arab Republic. In banking, public enterprises play an important and sometimes dominant role in India, Mexico, Pakistan and Uganda. In the tourist industry, they operate hotels and tour services, for example, in Jamaica and Thailand. State trading organizations dominate export and import trade in many countries.

2. Quantitative dimension

43. Public enterprise sectors have grown and diversified greatly in the past two decades in most developing countries. As regards the African region, parastatal sectors are larger in terms of gross domestic product and investment than in other regions. A study by the International Monetary Fund has shown that while the percentage share of gross domestic product at factor cost accounted for by public

enterprises worldwide was 9.4 per cent in 1974-1977, the aggregate figure for all of the developing countries was 8.6 per cent and that for Africa was 17.5 per cent. 4/ For the percentage share of gross fixed capital formation, it was 13.4 per cent worldwide for the same period, 27 per cent for the developing countries as a whole and 32.4 per cent for the African region.

44. In the Economic and Social Commission for Asia and the Pacific (ESCAP) region, there has been a marked growth in the number of public enterprises: in India, the number increased from 5 in 1951 to 153 in 1978; in Malaysia, from 10 in 1951 to 701 in 1979; and in Indonesia, from 103 in 1960 to 168 in 1979. As regards the semi-industrialized countries in Latin America, it can be mentioned that in Argentina there were 750 companies included in the inventory of firms totally or partially owned by the State in the mid 1970s. They accounted for approximately 30 per cent of all fixed investment in the country and were responsible for 45 per cent of the external debt. In the case of Mexico, parastatals account for 100 per cent of the production and distribution of energy, 100 per cent of air and railroad transportation and of communications, produce more than 60 per cent of the steel and 15 per cent of manufactures and, since 1982, include all of the banking services. 5/

3. Public enterprises as instruments of public policy

45. As instruments of the public sector, public enterprises are used in a wide variety of policy areas, from production to managing the economy and regulating economic behaviour. The objectives and "strategic missions" assigned to them in developing countries are to generate employment, control and/or manage strategic sectors of the economy, promote regional development, provide the basic infrastructure required for development, substitute imports and/or save foreign exchange, implement economic policies and/or plans, earn profits for investment elsewhere, provide traditional public services, counterbalance the power of domestic entrepreneurs and/or multinational enterprises, regulate markets, reduce income inequalities, prevent private business failures, avoid denationalization of local enterprises, enter into joint ventures with foreign capital, increase production.

B. Current issues and concerns about their role

46. Given the importance of the public enterprise sector and the scale attained by State entrepreneurship in most developing countries, it comes as no surprise to find that almost no country has been spared what appears to be a permanent debate about the role and functioning of public enterprises. During the 1960s and 1970s, the debate revolved around the initiatives for reforms mainly on the control, organization, management and accountability of public enterprises. In the 1980s, the losses and inefficiencies of many public enterprises are widely viewed as contributory factors to the budgetary deficits in several developing countries, and the debate focused on ways of reducing the financial burden caused by public enterprises through some divestment and by improving the efficiency and profitability of remaining public enterprises. The debate is further complicated

by developments in the international commodity and financial markets that compelled many developing countries to adopt policies of adjustment that have, among other things, called for fiscal retrenchment and reducing the public sector borrowing requirements.

47. The scenario of crisis depicted above had a tremendous impact on the approach of governments to the problems of their public enterprise sectors. Developing countries have initiated reviews both at the policy level on the role and scope of public enterprises as part of the search for an appropriate rate of the public sector and at a specific operational level on policies and measures to deal with deficit-ridden public enterprises. These reviews showed that to deal effectively with problems of public enterprises there is a need for a comprehensive approach, including selective divestment, policy reforms (e.g., pricing policies) to increase profitability, and institutional reforms to ensure effective government direction, control and evaluation.

48. These reviews revealed that rapid growth, multiple objectives and a diversity of external control systems imposed a variety of constraints - and additional costs - on the operations of public enterprises. They include such planning, direction, organization and control failures as poor feasibility appraisal and decisions about initial investments, conflicting priorities, poor corporate planning, little incentives for entrepreneurial behaviour, inability to generate income to maintain operations, inadequate arrangements for accountability, and trivialization of board and political supervision. A major challenge to improving efficiency in public enterprises in developing countries is to deal effectively with these constraints.

C. Public enterprise reform: recent efforts

49. Many developing countries have planned or implemented in the 1980s wide-ranging public enterprise reforms to meet the concerns mentioned above. Those reforms comprised three different groups dealing with improved oversight, divestment and improved management performance and control.

1. Institutional aspects

50. Several institutional arrangements have been used in developing countries to provide effective control and supervision of public enterprises. In some countries, they are under the oversight of sectoral ministries to which they are assigned; in others, there is, in addition, a central bureau that collects and analyses information about them and often performs other functions; sometimes supervising authority is removed from ministries and vested in a holding company; there is also the control and supervision provided by having the auditor general submit reports and accounts of enterprises to the legislature; and finally, the most recent approach to the problem of malfunctioning institutional structures in some countries has been the creation of "focal points" to oversee the public enterprises.

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51. In implementing the various alternatives, attempts were made to keep a clear distinction between policy formulation, control and evaluation, on the one hand, and the management of public enterprises, on the other. In some cases, however, they have nevertheless failed in providing the necessary degree of autonomy for effective management.

2. Divestment policies

52. Policies dealing with divestment of public enterprises, including outright sale, partial sale of equity and liquidation, have been adopted in many developing countries (e.g., Bangladesh, Brazil, Chile, Côte d'Ivoire and Nigeria). Divestment policies have emerged as a phenomenon of the 1980s, reflecting certain moderation of the interventionist impulses of the State in many developing countries, as well as their inability to cope with surmounting financial constraints caused to a great extent by negative external factors beyond their control. However, a gap of varying degrees has appeared in the implementation of these policies, reflecting severe technical, administrative and political bottle-necks.

53. First, the proper valuation of enterprise assets prior to the sale constitutes a very tricky undertaking. Second, divestment requires a capital market to exist in the country and, should that be the case, it also requires a sophisticated infrastructure of banks or investment brokers to provide outlets for shares and broader participation, all of which is hardly the case in most developing countries. Finally, there must be widespread political support for the rationale of divestment: particularly in the case of enterprises with a strategic role in the national economy, it is not enough to proceed on the basis that the activity could just as well be undertaken by the private sector. Political reality often requires difficult and costly efforts to explain the measures to be taken and to obtain support for their implementation.

3. Improving managerial performance and control

54. In countries with mixed economies, the economic measures adopted to raise internal efficiency in the parastatals are frequently oriented towards having them follow market signals more closely and be subject to the discipline of the market. Consequently, in several countries, where public enterprises have resorted to borrowing in the financial markets rather than depending on the treasury, prices have been raised and tax exemptions have been revised.

55. Efficiency in public enterprises is also being raised by the adoption of new and better managerial tools. Foremost among them are management information, monitoring and performance evaluation systems. Several countries have adopted or have improved their existing system. The best among those systems are kept simple and go from collection of detailed data (to suit the individual operating units' needs) to different degrees of aggregation (to serve the needs of the various planning, oversight and controlling agencies).

56. Training is widely viewed - together with appropriate salary and career planning policies - as a basic solution for improving managerial capabilities in

the parastatal sector. Training programmes are beginning to be designed considering the specific needs and characteristics of top managers of the public enterprises and high level officials of the various oversight and planning agencies concerned with them. Finally, and regarding managerial performance on the job, reform efforts point to the ways for strengthening accountability and responsibility for results. A key factor here is managerial motivation, that is to say, how to relate closely the incentives of managers (both monetary and non-monetary) to the performances of enterprises. "Contract programmes" are among the techniques being tried to that effect in some countries.

4. Emerging trends

57. A growing consensus is emerging in many developing countries on a flexible but cautious approach with respect to public enterprises. Several elements of this approach can be identified. First, governments show considerable caution in creating any new public enterprises or expanding the scope of the existing ones. Second, many governments recognized the need to maintain a flexible approach to adjust the role and expansion of public enterprises with the growth and maturity of the private sector in their national economy. In countries with mixed economies, periodic reviews are being undertaken to initiate divestment of appropriate public enterprises as market institutions flesh out and private entrepreneurship and managerial experience is built up, thereby reducing the need for the State to act as catalyst and surrogate. In some countries, flexibility has been shown in allowing increasing participation by the private sector in both equity and business operations of selected public enterprises. Third, along these cautious and flexible approaches, many developing countries are intensifying their efforts at improving the efficiency and effectiveness of their public enterprises. This reflects a widespread realization by developing countries that public enterprises will continue to figure prominently on the economic scene for a good many years to come, albeit with a tightened management and greater exposure to the discipline of the market.

V. IMPROVING EFFICIENCY AND EFFECTIVENESS OF THE PUBLIC SECTOR

58. As shown in the preceding sections, the public sector has a pervasive influence on the economic development of all developing countries. It provides basic public goods such as law and order, a monetary system, an economic framework covering commercial, fiscal, income and price matters, infrastructure services such as transport, power, water and the like, and social services including health, education and housing. As the overall regulator and promoter of economic development, the public sector sets and implements development priorities, plans and programmes, and deals with problems of trade, finance and investment in the national, regional and international contexts. As a direct participant, it produces mainly through public enterprises various economic goods and services.

59. In recent years, several economic factors, such as declining rate of economic growth, rising external debts and increased government deficits have raised concerns about the proper role and scope of the public sector in economic development. The public sector is said to have expanded too much and to have

consumed scarce resources in an unproductive manner, in particular its deficit producing public enterprises. Public management systems have not developed adequately to respond to rapidly changing issues of trade, finance and development in national, regional and international contexts. In some cases, the regulation of trade and industry is said to introduce distortion in economic management, and generally to have delayed beneficial development. In general, there is a growing perception that while the public sector has responded effectively to market failures to promote economic development (e.g., Brazil, the Republic of Korea and Yugoslavia), it has also shown varying degrees of organizational failures.

60. In these circumstances, there have been demands for major changes to improve the efficiency and effectiveness of the role of the public sector. These have included a modification of its role and scope, a realignment of institutional and staff capacities, better economic management in the face of worsening economic situations, measures to promote efficiency, economy and productivity in public management, and improved evaluation and accountability for public sector activities. Developing countries are responding to these demands in various ways, often as part of the stabilization and structural adjustment programmes initiated by the World Bank. These responses are briefly reviewed under the following four sections: policy reform, institutional and personnel reform, financial management, and improved evaluation and accountability.

A. Policy reform

61. Selection of appropriate policies and programmes, their effective implementation and the evaluation of their impact are crucial to improving the public sector's performance. But this requires a consensus on the part of policy-makers on the role and scope of the public sector. Countries that exhibit such consensus (e.g., Brazil, and the Republic of Korea) have shown greater consistency and compatibility in their economic policies and achieved much better public sector performance than others (e.g., Argentina and Mexico) where a lack of such consensus has led to conflicting policies and resultant non-realization of policy goals.

62. In addition, the Governments of many developing countries, especially those with mixed economies, have become aware of the need to find a balance between the public sector and activities of other sectors in order to stimulate initiative and dynamism in the economy. Responses include the liberalization of industrial licensing, external trade, credit restrictions, and business incentives, strict control over public enterprises, and expansion of the scope of the private sector to participate and compete in selected activities hitherto controlled by the public sector.

63. Aside from policy reforms in the national context, it is now increasingly realized that macro-economic policy and performance in industrial countries affect developing countries in a variety of ways. Changes in the pace of economic growth and inflation, protectionism in industrial countries, shifts in interest rates and exchange rates can all influence developing countries' performance through the markets for goods and services or through financial markets. In many ways, the countries of the world have become so interdependent that for many developing countries the prospect of their development cannot be separated from that of the

world economy, and, consequently, an increasingly important role of the public sector is to ensure on a continuing basis the co-ordination of economic and monetary policies with those of the industrialized countries.

B. Institutional and personnel reform

64. The effectiveness of the public sector depends largely on the machinery of government. Sustained efforts are being made to raise efficiency in public administration, especially in the area of national economic management. Periodic examination of the structure and operation of public administration including personnel and financial administration aspects, has been undertaken in most developing countries. In recent years, such examination has led to the creation/strengthening of various devices to co-ordinate national economic and fiscal policies, monitor and co-ordinate debt management and promote the performance of public enterprises.

65. These institutional reforms have been accompanied to varying degrees by reforms in the personnel system and training. Lack of trained staff, especially those needed for economic policy analysis and management, inadequate training facilities for those currently employed and inability of the public sector to attract and retain competent staff in the face of competition from the private sector and outside countries are some of the key challenges that beset public management in developing countries. Though the situation varies, it is generally agreed that the severity of the problem is more acute in Sub-Saharan Africa than elsewhere. Moreover, improvements designed to strengthen training facilities and make salaries and benefits of public employees less inequitable are constrained by public revenues. These concerns have led many developing countries to assign high priority for integrated human resources development for public management performance. This priority for improving the human resource factor in development has also been reflected in the international arena, the emphasis contained in the United Nations Development Programme (UNDP) fourth cycle planning, as well as in the General Assembly resolution on the role of the qualified national personnel.

C. Financial management

66. Improved budgeting, accounting and auditing systems have been increasingly recognized to achieve more efficiency in the public sector. Regardless of the method, the budgeting process is always a matter of great concern to decision makers, since nothing is supposed to happen in government without budgetary authorization or approval. Efforts in developing countries are now oriented towards achieving better integration between budgetary and accounting systems.

67. In the area of government accounting, the information requirements for effective management of national economies have been re-evaluated. Effective management of government programmes involving improved accountability and performance appraisal call for data which allow determination of costs, benefits/outputs, cost-effectiveness, productivity and performance measurement. The need for additional financial information has led some developing countries to consider certain accounting reforms. Among them, one is the adoption of accrual

accounting not as a replacement for the cash and obligation bases but on a selective and supplementary basis, particularly to facilitate policy formulation, management and control of resources and effective audit.

68. Auditing is another area of high priority in the efforts of developing countries to improve their public financial management systems. Performance auditing is widely recognized as the appropriate tool to determine the efficiency, effectiveness and economy of government programmes and many developing countries are experimenting in this area. Training to develop the capability to carry out performance audits and the formulation of appropriate public sector audit standards are priority activities in many developing countries. Likewise, strengthening of internal management control systems and of the internal audit function are regarded as essential ways of achieving greater public sector efficiency.

69. Another crucial subject in the public financial management context of developing countries is the current critical external debt situation. National economies have deteriorated because of the burden of the external debt in a majority of these countries. Regardless of the several causes which have led the developing countries to this situation, public managers now recognize the urgent need for effective management of indebtedness operations. Until recently debt management has been, by and large, very poor. The absence of reliable, accurate and timely data on outstanding external obligations and on debt-service payments falling due, has contributed to inefficient management of foreign exchange reserves, waste of resources, inadequate rescheduling of debt and the like. Therefore, there is general realization that the external debt problem, aside from its purely economic and political factors, requires adequate management and monitoring.

D. Improved monitoring, evaluation and accountability

70. Governments of developing countries need to strengthen monitoring and evaluation as a way of enhancing performance and accountability for public sector activities. Many Governments have created or strengthened their national agency for systematic review and evaluation of their development programmes and projects. These Governments have also made efforts towards increased use of information technology, particularly computer-based information systems for monitoring performance. However, methodological problems in devising appropriate standards and criteria for measuring performance in the public sector persist, especially when such standards and criteria in the private sector are not easily transferable. In some countries (e.g., Brazil, Pakistan and the Republic of Korea) monitoring and evaluation of public enterprises have attained significant improvements in both methodology and operation.

VI. EXPERIENCE OF DEVELOPING COUNTRIES

71. A useful line of activity at the international level is the exchange of experience and information among developing countries on the role of the public sector in promoting economic and social development. Questions of particular

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interest to developing countries, and which could become the subject of fruitful exchange, include those relating to institutional structures, their linkages and capabilities for effective national economic management, public enterprises, and the way the machinery of government has responded to demands for improved performance and productivity in public management.

A. Ways of improving national economic management

72. A major challenge faced by developing countries is how to respond to significant changes in the international economy. Governments of developing countries have adopted various approaches and measures to meet this challenge. One set of measures includes policy reforms in fiscal, monetary and economic matters. Another set deals with changing institutional structures and enhancing technical capacities to implement these policy reforms, including their harmonious co-ordination with policies of industrialized countries, especially in the area of trade, finance and investment. Yet another set deals with measures to ensure better monitoring and evaluation of policies and programmes for economic management. The experience of developing countries in building an effective economic management system is varied and a better understanding of the selection of strategic policies and institutions that are appropriate to various patterns of national economic issues would be of immense value to those concerned with the role of the public sector in economic development.

B. Assessment of public enterprises

73. For most developing countries with mixed economies, the end of the 1970s has seen the zenith in the expansion of public enterprises. As shown earlier, the performance of public enterprises has been mixed, and developing countries have adopted various measures to make them more efficient and effective in realizing their policy objectives. A selective policy of divestment and semi-divestment of public enterprises was adopted in many countries, although implementation was somewhat limited due to political (e.g., bureaucratic and political pressures), technical (e.g., valuation criteria) and procedural constraints. Measures to improve the performance of remaining enterprises through managerial autonomy, corporate planning, performance contracts and similar devices were also adopted with mixed results. Many Governments have also instituted mechanisms to monitor and evaluate the performance of public enterprises, even though agreed performance criteria and standards are not always clear. An analysis of the experience of reform in public enterprises would be of great value to developing countries.

C. Performance in public management

74. In many developing countries, governmental concern regarding improved performance in public management has been widely reflected in policy statements and documents, and in efforts to improve and monitor the performance of public agencies and their officials. The result is mixed and there appears to be significant gaps in understanding management performance problems, their underlying causes, and how

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to overcome them in public organizations. One of the major problems may be the public service environment itself which engenders three major constraints, namely, multiple priorities (e.g., national unity and regional development), administrative and procedural constraints, and disincentives to efficiency. Another problem seems to be government's understanding of key dimensions (e.g., political, administrative and technical) of performance. An analysis of experience related to crucial components and constraints of performance improvement could be very useful to developing countries.

D. Activities of the United Nations system

75. Organizations of the United Nations system have facilitated the exchange of experience and information on the role of the public sector in developing countries. During the period 1983-1986, several interregional and expert group meetings were held to review various aspects of the role of the public sector, its management systems and practices, and the working and performance of public enterprises. Based on those meetings and other research studies, the United Nations system has also published several monographs which aim at disseminating information and experience regarding the role of the public sector among developing countries.

76. The Department of Technical Co-operation for Development of the United Nations Secretariat, in co-operation with the Economic and Social Commission for Asia and the Pacific (ESCAP), organized an interregional seminar on the role of the public sector in the mobilization of domestic financial resources for economic and social development in December 1985 at Bangkok. The International Center for Public Enterprises in Developing Countries (ICPE) held an expert group meeting on the role of the public sector in regional development in developing countries in November 1984. The United Nations Industrial Development Organization (UNIDO) has prepared a series of country studies on the role of the public industrial enterprises in economic development (1983). In recent years, the Department of Technical Co-operation for Development has organized several meetings on different aspects of public sector management, such as management training of scientific and technical personnel (1983), modern management and information systems for public administration in developing countries (1983), accrual accounting in developing countries (1984), public auditing and internal management control systems in developing countries (1984), government budgetary methods and procedures (1985), audit standards in developing countries (1985), management development of senior administrators (1985), and audit of major development projects (1986). The managerial and institutional aspects of development covering key aspects of public sector management in the development process were also highlighted by the World Bank. 6/

77. As regards public enterprises, the Department in collaboration with ICPE organized an interregional workshop on performance evaluation of public enterprises in developing countries in November 1983 at Ljubljana, Yugoslavia. 7/ The Economic Development Institute of the World Bank and ICPE jointly sponsored a seminar on public enterprise management practices and systems with particular focus on developing countries in 1985. ICPE also organized meetings on the role of public enterprises in employment (1983) and the role of public enterprise/financial

institutions (1983). Both the Department (1986) and ICPE (1983) organized one meeting each on the role, performance and management practices of public enterprises joint ventures.

78. The emphasis in those meetings and publications has been mostly on public enterprises, public management systems, and selective aspects of the role of the public sector. However, amongst other key considerations mentioned in General Assembly resolution 34/137 were the linkages and interface between the public and other sectors. Developing countries have acquired valuable experience in recent years in this area. Accordingly, it would be useful if opportunities were provided for the exchange of this experience at international seminars, the results of which could be subsequently disseminated to a wider audience.

VII. CONCLUSIONS

79. The public sector plays a dominant role in the economic development of developing countries. Its leading role has customarily taken several forms. It mobilizes a large proportion of the total economic resources of a country in the form of government revenues. In allocating these resources and also through its monetary and credit policies, it determines the principal directions of economic and social development. It provides planning for development, lays down economic and social infrastructure, determines critical prices and regulates the activities of other sectors. It undertakes, through its public enterprises, direct production and distribution of certain goods and services. In many developing countries, the public sector constitutes the major force for bringing about structural change.

80. However, the economic crisis of the 1980s as reflected in increased national budgetary deficits and changes in international commodity and financial markets has brought renewed debate on the role of the public sector. Demands for reform have been raised in many developing countries. In responding to these demands, developing countries have made changes in macro-economic management, micro-economic regulation, scope and character of public enterprises, organization of the public service and public financial and personnel management. Although the measures taken in many countries are impressive, much remains to be done.

81. It is increasingly recognized that economic development requires the resolution of structural constraints, as well as providing conditions for effective economic management for many developing countries. Economic development in the short- and medium-term will owe as much to improved productivity as to innovative and sound economic management. Herein lies the critical challenge facing the public sector: provision of a co-ordinated policy framework for increased productivity, strengthening capacities for effective economic management and enhancing the effectiveness and efficiency of the public management system in consonance with a country's national objectives.

82. In recent years, developing countries have accumulated a rich variety of experience concerning the role of the public sector in economic and social development. This body of experience has not been systematically reported to those who might best profit from it. The analysis, discussion and dissemination of such

information will contribute to a better understanding and appreciation of the role of the public sector in promoting economic and social development.

Notes

1/ International Monetary Fund, World Economic Outlook (April, 1985), p. 64.

2/ Economic Report on Africa, 1984, p. 5.

3/ World Bank, World Development Report, 1986, table 18, p. 214.

4/ R. P. Short: "The role of public enterprises: an international statistical comparison", in Public Enterprise in Mixed Economies: Some Macro-Economic Aspects (International Monetary Fund, Washington, D.C., 1984), pp. 126-129.

5/ Jorge Barenstein: La gestión de empresas públicas en Mexico (Centro de Investigaciones de Desarrollo Económico, Mexico, 1983), pp. 75 and 182.

6/ World Bank, "Management in development" in World Development Report, 1983, pp. 41-128.

7/ United Nations, Performance Evaluation of Public Enterprises in Developing Countries: Criteria and Institutions (TCD/SEM.84/5), New York, 1984.
