UNITED NATIONS

ST

Secretariat

Distr.
LIMITED

ST/SG/AC.6/1995/L.6
6 July 1995

ENGLISH ONLY

TWELFTH MEETING OF EXPERTS ON THE
UNITED NATIONS PROGRAMME IN PUBLIC
ADMINISTRATION AND FINANCE
New York, 31 July-11 August 1995

PUBLIC-PRIVATE INTERACTION

CONTENTS

CONTENTS (continued)

INTRODUCTION

1. The world is emerging from a period that dates from the late 1950s to the late 1970s, in which Governments widely considered themselves to be the engines of growth of their economies. Cadres of public servants expanded and the public enterprise form of economic organization was extensively used in the expectation that that would facilitate national planning, give Governments control over the commanding heights of the economy and provide a flexible instrument for achieving a mix of growth, distributional and political objectives.

2. The drift away from Keynesian demand management, the statism of Prebisch and interventionist approaches to enterprise management, together with the spread of liberal market-oriented ideologies, have been accompanied by export-oriented policies, pragmatic and supportive relationships between the State and the private sector, active diversification towards manufactures, increased human resource development and higher levels of national savings. Those changes have taken place unevenly around the world. In South and East Asia, development has been export led but has occurred within protected domestic markets in which Governments have been strongly interventionist. In Latin America, economic policy reform has taken hold in a few countries but the take-off is still frail and subject to exogenous shocks. Africa is still in a stagnant period, with low growth often outstripped by population growth.

3. In the 1990s, public enterprises are still responsible for a large fraction of aggregate investment, credit expansion, employment and domestic production. Global data are scarce, but public enterprises were estimated to have produced 10 per cent of world value added in the mid-1980s. In the countries with economies in transition, the share of public enterprise in value added has been very high, ranging from 65 per cent in Hungary (1984) to 97 per cent in former Czechoslovakia (1986) (Savas, 1991). In the developing countries, that share has not been as high but is still higher than average: 17 per cent of gross domestic product (GDP) in sub-Saharan Africa and 12 per cent in Latin America. Public enterprises in developing countries are big users of scarce investment funds, accounting for 25 per cent of gross fixed capital formation.

4. Public enterprises 1/ actually make up a relatively small part of the public sector overall, which includes central and local governments and other decentralized bodies. Government spending in 1986 accounted for 38 per cent of global gross national product (GNP) or GDP, which indicates the importance of current trends away from public-sector production of goods and services and the potential impact on global welfare.

5. A view that is gaining widespread acceptance is that the economic role of government is to enable national development, primarily through private-sector development. That role is played in three ways: by creating a stable and market-friendly environment; by promoting and encouraging more players to enter the entrepreneurial field; and by providing regulation to keep the field level and fair for all, particularly vulnerable groups, such as customers, investors, employees and users of the environment. Government is redefined in terms of macroeconomic policy-making, legislation and enforcement, catalytic promotion and regulation.

6. The problem is one of restructuring the public sector for private-sector development. The public sector may be seen in terms of the following four-cell matrix, divided into (a) core and non-core activities, as defined by the Government in response to the preferences of the electorate, and (b) high and low-productivity activities:

	Core	Non-core
High productivity	A	B
Low productivity	C	D

7. Cell A activities - highly productive core activities - are retained by the Government. Cell B activities - highly productive non-core activities - are transferred to the private sector; they would include all purely commercial activities. Cell C activities - core activities of low productivity - are reformed, using private-sector inputs. Cell D represents non-core activities of low productivity; if they cannot be made commercially viable, they are discontinued.

8. It is important to emphasize that the new thinking does not diminish the importance or responsibility of Governments - no "withering away" of the State is envisaged. On the contrary, the bigger the role of the private sector at the microeconomic level, the more essential the role of the State becomes at the macroeconomic level. Nor does it imply a move towards State minimalism or laissez-faire economics, or an unregulated chaos in which only the strongest survive. On the contrary, enterprises flourish and the public welfare is served only where there is a clearly defined and stable framework in which operators can cooperate or compete as seems best to them. The experience of the rapidly growing economies of East and South-East Asia shows that, at least in certain countries in certain situations, there is a case for a stronger strategic role of government in industry.

9. The present paper reviews recent changes in thinking about the role of Government and about forms and modalities of interaction with the non-State sector, in a world in which the production of goods and services is increasingly being taken forward or taken over by private organizations and individuals. The paper focuses on the role of Governments, rather than that of private firms, banks, trade associations, customer associations or any of the myriad other non-government organizations in the business sector. Sections I, II and III review the three ways in which Governments play their role (stabilization, promotion and regulation). Section IV covers the State’s progressive divestment of its management of public enterprises. Section V reviews the role of technical assistance, particularly by the United Nations system, in facilitating those changes. Section VI concludes with some speculation about the continuation of the above-mentioned trends and developments into the next century.

I. STABILITY AND MARKET FRIENDLINESS

A. Stability

10. All development presupposes an environment in which people, entrepreneurs in particular, are able to look forward with a certain minimum level of confidence. In terms of the peace-development continuum, productive economic activity depends on the establishment of peace, or at least an expectation that the efforts of today will result in returns to the effort maker tomorrow. All investment is future-oriented. It has been observed that during civil wars, markets are fragmented, making trading more profitable, but that profits are saved and not invested. Insecurity keeps portfolios liquid. Even where public laws are not observed, as in some of the rapidly privatizing transitional economies undergoing shock therapy, the need for order is a very real prerequisite to all productive activity, even if that order is created by criminal organizations that divert income from lucrative activities conducted according to their own rules. It is evident that stability in all its aspects - political, social, economic - supports long-term economic activity.

11. The need for minimum order and the rule of law does not imply a lack of change, or even radical change. Indeed, entrepreneurial activity thrives on the opportunities created by rapid and uneven exogenous changes. A thrust in one direction creates gaps and profit potentials in other areas that are affected. As potentials are recognized, entrepreneurs rush to exploit the new opportunities. The concept of balanced development increasingly appears to have been a myth that faded out with the demise of central planning.

12. Similarly, the ideal pace of change is a question that has been much debated, especially in the privatization of the transitional economies, where the vast number of public enterprises has necessitated new approaches. It has been argued that a regime that favours privatization has a window of opportunity, perhaps only in the short term; therefore it should rapidly institute a set of reforms before opposition can coalesce and should put the programme into an advanced position before the reaction sets in. Though rapid adjustment has cost some countries dearly in terms of production collapse, unemployment and crime, it has been argued that the alternative might have been still worse. But it has also been argued that failure to respect the democratic and participatory basis for development will result in stronger and more destructive reactions; reformers should seek participation and consent in order to make the reforms sustainable, rather than focusing exclusively on the pace of reform. The issue remains controversial.

B. Property rights

13. Private-sector development is based on the concept of private property. Clear rules for the distribution of economic returns from the use or disposition of property establish incentives for property owners to put their assets to the most productive use or to transfer them to those who can use them better. Should the State need to acquire property in exceptional cases, such as for defence or transport projects, clear rules should exist for determining fair

compensation. Property laws are generally built into the constitution of a country.

14. In countries that have inherited diverse property concepts, immense legal and institutional changes are taking place. Ambiguity on who owns the State enterprises - the workers, the Government or the people generally - has allowed spontaneous privatization by opportunistic managers and nomenklatura. For example, disputes over ownership led Poland to first nationalize the enterprises so as to eliminate all doubts over ownership. Clarity in property rights is a precondition of privatization, which is essentially the transfer of property rights.

15. Issues have arisen with regard to the claims of former owners who were expropriated by earlier regimes. Some countries have opted for the restitution of such property to its former owners; however, this only works if the expropriation was relatively recent, if the former owners or their descendants can prove title, if their claims can be balanced against the claims of subsequent owners who acquired the property in good faith, and if the courts have the capacity to resolve large numbers of complex claims. Other countries have preferred to compensate former owners financially; if a law is passed to substitute rights to compensation for all prior ownership claims, the Government can go ahead with privatization in advance of settling claims.

16. Due to national sensitivities, restrictions often apply to foreign ownership and to the ownership of natural resources.

17. Privatization may be seen as benefiting only foreigners or the few powerful families who have the money to bid for enterprises put up for sale. This has led to a policy of establishing broad-based ownership, which is intended not only to spread benefits more widely but also to awaken public interest and support and make privatization politically irreversible, as in the United Kingdom of Great Britain and Northern Ireland. Broad-based ownership may be achieved by limiting the size of individual allocations of shares in a public issue and by reducing the price of shares. Where domestic savings are low, enterprises have been given away free by means of voucher schemes. Voucher schemes have been successfully used in a number of transitional countries, where they have also served the need to privatize a large number of enterprises quickly, but they are equally applicable in developing countries.

18. Establishing broad-based ownership carries the risk of "orphaning" an enterprise: ownership of shares may be so widely diffused that there is no dominant shareholder to check the management. Good corporate governance requires knowledgeable owners. Some schemes combine the sale of a controlling interest to a core investor (as in a trade sale) with a broad-based sale of the balance of the equity. Alternatively, vouchers are purchased by financial intermediaries, such as unit trusts, which can apply professional portfolio management skills. In the long run, the development of a stock exchange allows controlling interests to emerge naturally.

C. Legal infrastructure

19. A market-friendly legal environment requires not only establishing laws and regulations on property, bankruptcy and insolvency, the formation and management of companies, partnerships and joint ventures, securities, banking, insurance, taxation, accounting practices etc. but also establishing the courts and administrative personnel to support, implement and enforce them. Developing countries may have market economies and the basic infrastructure of commercial law but they frequently lag behind in the enforcement of rights; the enforcement of debts, for instance, may take several years and may cost more in legal fees than it is worth. Property is potential security for credit but only if the titling, registration and cadastral mechanisms function, along with mortgaging procedures and foreclosure systems. Intellectual property is particularly subject to theft; incentives for the domestic development of intellectual property and for the import of technology depend on the protection of patents, trademarks, copyright, trade secrets, know-how and licensing agreements.

D. Price and accounting distortions

20. Beyond the protection of life and property lies the economic role of getting the prices right so that resources are allocated where they will be most productive. Subsidies, price controls, interest-rate controls and exchange-rate controls distort the price structure. They are being widely discontinued (except for foreign transactions on capital accounts) and, where necessary, there is direct targeting of relief to those who are harmed. Without these very basic reforms, and the maintenance of the internal and external value of the currency unit, accounting profits and losses are poor guides to efficient resource allocation. It is widely agreed that macroeconomic stabilization is a prerequisite for structural reform. It is not so widely understood that even moderate levels of inflation seriously distort accounting data and influence resource allocations in unpredictable directions.

E. Intervention policy stability

21. There is a well-known case for government intervention in markets that do not maximize welfare on their own, due to market weaknesses, such as imperfect competition, economies of scale, external costs and benefits of production and consumption, public goods and imperfect information. Governments have to formulate appropriate correctional policy and try to maintain policy stability. Frequent swings of policy cause high learning and transaction costs and increase the risks attaching to future cash flows, with adverse effects on investment. Market weaknesses are more severe in developing countries and transitional economies than in developed countries. The need for intervention is greater in these economies, but there are corresponding weaknesses in the capacity of their Governments to intervene without distorting or suppressing free-market activity. The problem is one of balance: imperfect markets versus imperfect Governments.

F. Culture

22. The culture of the country may not be friendly to entrepreneurship, particularly where former leaders had espoused a philosophy antipathetic to individual economic venture. In the Central European countries, social acceptance is growing, in particular in Hungary. Even in market economies, entrepreneurial activity may be seen as anti-social or of low status. Popular attitudes survive, such as the characterization of market intermediation as hoarding or speculation, and the high marriage status attached to those with government jobs. The Government may then have an educative role: through the education system, special campaigns and national honours, it can raise the status of business activity.

G. Administrative deregulation

23. Many developing countries have a high level of administrative regulation of business. Investors, entrepreneurs and their agents face a battery of requirements before they can obtain licences, permits and approvals. And since these are often spread through a dozen or more government agencies operating independently (and often corruptly), there is a high barrier and a disincentive to starting any business. Several Governments have examined the rationale for their administrative controls and simplified and streamlined them, often creating a one-stop agency to reduce the cost and delay, particularly for foreign investors. Argentina, for instance, passed a decree in 1991 closing dozens of government agencies and eliminating petty bureaucratic controls. Policies in the 1980s showed a trend towards liberalization and the deregulation of foreign-direct investment (FDI) in the form of the granting of guarantees and incentives and the reduction of obstacles, restrictions and requirements. The potential contribution of FDI to economic development and the transfer of technology has been generally recognized in developing countries. Acceptance of the likelihood of beneficial cooperation with transnational corporations has replaced the assumption of unavoidable conflict. (UN-CTC 1988: 262).

24. In every country, there is an unlicensed and untaxed informal sector, comprising sole traders, micro and small-scale enterprises, mainly in the agriculture, construction, trade and service sectors. In many countries, such as in Africa, that sector is responsible for a high share of GDP and employment, even exceeding 50 per cent. Governments are becoming more tolerant of their informal sectors and are seeking ways to integrate their activities into their programmes. Administrative deregulation has the further advantage that it attracts more enterprises into the formal sector: enterprises thereby acquire a legal status that allows access to credit from the formal banking system (which is otherwise virtually unused by them) and to government technical support and training facilities.

II. PROMOTION OF BUSINESS

25. According to the new paradigm of economic management, the prime mover in the promotion of new business activity is the entrepreneur, who sponsors, part-finances and manages new resource combinations. The prime mover in the growth

of existing businesses is enterprise management. The role of Government is to provide the legal and policy framework for all business activity - a macroeconomic role - but to stop short of identifying projects or promoting, financing or managing them at the micro-economic level. Nevertheless, where Governments have long been the prime movers and have accumulated business experience and national and international contacts, and where they employ many of the most able and educated members of society, the transition to an economy driven by the private sector is likely to be a long process of adaptation, marked by various forms of joint public-private initiative.

26. There is a broad consensus in favour of promoting competition as a means of achieving higher allocative and productive efficiency. Despite continuing protectionist markets in the developed countries and the newly industrialized Asian tigers, the international donor community favours the opening up of trade and investment internationally so that it flows to where the returns are highest. Two aspects of competition policy should be distinguished: (a) open up the playing field (break-up of monolithic enterprises, market deregulation, liberalization, investment promotion and export promotion) and (b) the need to level the playing field (discontinuation of preference to State enterprises, social control of monopolies, control of restrictive business practices and investor protection). The second aspect is discussed in section III, "Regulation". The first aspect, that of getting more players onto the field, is reviewed below.

27. Evidence from countries ranging from Nigeria to the Republic of Korea has shown that potential entrepreneurs are very responsive to economic incentives. The deregulation of markets previously reserved to the public sector, usually as monopolies of particular public enterprises, allows more efficient operators into the market and can have rapid and dramatic effects on entrepreneurial activity and overall resource efficiency. In Poland in 1990, farmers were allowed to bring food directly to the market themselves, thereby bypassing the State-monopolized food distribution sector. In a matter of weeks, farmers' markets sprang up all over Poland. The free-market prices for food are generally lower now than prices in the official stores. Another policy aimed to break up monopolies in specific sectors, such as coal, publishing and retail shops, mainly by dividing large, multi-plant enterprises into several independent units and by eliminating industry-wide cartel-like associations.

A. Women entrepreneurs

28. Some new sources of entrepreneurship are being tapped, such as women and displaced public-sector civil and military personnel, as well as youths entering the job market each year.

29. Women represent half a country's potential entrepreneurs, but in most developing countries (unlike the transitional economies) they face major social and legal obstacles to their participation in economic enterprise. There are special programmes for tapping this major source of entrepreneurial ability. In some countries, rather than provide separately for women, more is done to ensure their representation in mixed gender programmes. New women entrepreneurs often

draw on savings, increase investment and exploit new market opportunities, thus mobilizing new capital and markets.

30. Women are very active in micro-enterprises, the informal sector and artisanal development, and a variety of programmes have been launched to support women micro-entrepreneurs through credit and extension services. One successful programme is the Self-Employed Women's Association in India, which has organized and helped over 35,000 women to become independent and self-employed in a wide range of occupations. More than half those benefiting from micro-enterprise programmes are women, even where they are not specifically targeted. Micro-enterprise programmes have frequently raised the incomes of the households in which poor women live and enhanced their status in those households. Programmes typically provide credit, training and technical assistance, and occasionally marketing services as well. Non-governmental organizations are particularly active in running such programmes.

31. Except in micro-enterprises, women are generally underrepresented among entrepreneurs. Surveys show that women entrepreneurs have roughly the same psychological and social make-up as male entrepreneurs. Vigorous programmes in a number of countries have succeeded in increasing the participation of women entrepreneurs in the small, medium, and large-enterprise sectors, as well as among the very smallest entrepreneurs. Specific measures taken by Governments and enterprise management have resulted in increases in the numbers of women enrolled in higher-level management education and entering management and technical training institutions. This is also due to a growing consciousness among women throughout the world of their creative potential. Despite a rapid increase in their representation, proportionally women are still a long way behind men: the process of involving women in large-scale entrepreneurship is still in the early stages.

B. Public-sector civilian personnel

32. In many countries, Governments are scaling down public expenditure as part of their adjustment programmes, and since a high proportion of public expenditure consists of civil-service salaries, this implies major personnel retrenchment. Public enterprises are sharing the same fate: whether they are restructured and remain under public ownership, restructured ready for sale, restructured after sale or liquidated, and however retrenchments are effected, the end result is large numbers of persons joining the mass of unemployed. Public enterprise tends to be capital intensive, so that the numbers involved are not high relative to, for instance, the annual increment from school-leavers. However, this understates the social and political significance of the problem: public sector employees who have had steady jobs all their lives tend to have large numbers of dependants and also tend to be well organized and politically connected.

33. Since the public sector does not generally encourage or reward entrepreneurial initiative, innovation or risk-taking behaviour, retraining programmes must place great emphasis on those traits and attempt to change attitudes. On the other hand, ex-public sector personnel have an important advantage in that they have political and government contacts and know how the

system works, although that advantage may also be used against the public interest to get preferential treatment from government officers. Despite such problems, efforts should be made to identify potential entrepreneurs from the public sector and give them the minimal support they need to start up in the private sector.

C. Conversion of defence industries and budgets

34. Despite the ending of the cold war, new sources of conflict have erupted and the peace dividend has been elusive. Nevertheless, many Governments are now attempting to reduce their military expenditures in favour of civilian needs; transform military facilities, such as manufacturing complexes and decommissioned bases, to civil purposes; and provide productive employment for demobilized personnel from armies and guerrilla forces who need to be reintegrated into the peacetime economy, as is the case in Mozambique, El Salvador and Cambodia.

35. Such conversion is not always easy. In economic theory, the resources of declining industries are converted to more productive uses by the operation of market forces that offer higher returns elsewhere, but this does not necessarily apply to defence facilities. For one thing, military activities are geographically highly concentrated, so that their decline harms whole communities. For another, the political and social costs of conversion are higher: Governments are under tight fiscal constraints, while ever-increasing social and economic demands on government budgets and structural reform constraints on fiscal deficits have made it difficult to fund conversion directly from decreased military expenditures. On the other hand, some defence industries in the technologically more advanced countries that previously served only their own Governments are finding new markets abroad.

D. Education and training programmes

36. Effective entrepreneurship requires a strong human-resource base. Routine labour-intensive industries need workers with basic literacy and numeracy. Beyond this, the development of technology-intensive enterprises is contingent on a highly skilled and technically educated labour force, which is the focus of much current development. It is no accident that the countries that have experienced rapid entrepreneur-led growth in recent decades have high levels of general literacy and large numbers of trained technicians.

37. Educational reform should be a key element in a successful programme for entrepreneurship development: technical, personnel and business management skills should form the core of curriculum reform. Resources need to be diverted to continuously upgrade and restructure the educational system towards tertiary and technical training. Other skills essential for entrepreneurial development include such business skills as accounting, use of statistics, information gathering and processing, and economic and financial analysis.

38. Governments are often expected to organize, fund and administer major training and retraining programmes, but this is not a practical proposition

where Governments themselves are in crisis or where there is generalized corruption. In some countries, training is contracted out to non-governmental organizations. In Chile, for instance, the Government contracted with private firms to give training to unemployed youths. The specification of the training - its content, timing, venue and methods - was left to the contractors. Payment was made on results: $500 for each youth placed in a permanent job, whether within the firm or outside. In this way, 150,000 youths were trained, of whom 100,000 received jobs. That approach avoids the common anomaly of training and certificates being issued by training institutions but trainees still being unable to find jobs.

39. Entrepreneurship training is now frequently provided in technical schools and management colleges, and entrepreneurial orientation programmes are growing in popularity in secondary schools. In order to increase the proportion of viable businesses arising out of such programmes, the choice of projects is preferably made by the young entrepreneurs, whose drive is essential to getting projects off the ground. The financing of such projects should derive partly from entrepreneurs' private sources, so as to ensure their full-time commitment, and partly from financial intermediaries that have a financial interest in working with and advising entrepreneurs in the formative stages. Development finance institutions can act as channels of technological support and marketing information, as well as accounting and managerial know-how, for their own benefit as well as the benefit of entrepreneurs and managers.

E. Economic infrastructure

40. Another supporting role that Governments should play is to ensure the provision of economic infrastructure, such as roads and other transportation needs; telephone and other communication facilities; supply of power; and water-supply, sewerage and waste disposal. The overall planning of the physical infrastructure remains a government responsibility in every country, due to the significant externalities and public goods elements involved in such services. Pricing also remains a government responsibility because of its monopoly implications. For example, in a recent issue of the Harvard Business Review (November/December 1993), it was pointed out that in such countries as Viet Nam, the major constraint on growth is the physical infrastructure, which cannot be developed fast enough for the explosive increase in demand. The telephone is the most powerful tool of the entrepreneur, because it provides a vital link with the world beyond the village. Yet the world has less than a billion telephones for 6 billion people: the entire continent of Africa, with over 500 million people, has less telephones than the city of Tokyo. Only a few countries have so far achieved universal access to the telephone, and the gap between developed and developing countries is increasing rather than closing.

41. However, Governments are becoming less involved in the financing of infrastructure (despite the large amounts of investment required) and its operation. There is an increasing reliance on private-sector participation in the financing, construction and operation of new facilities through build-operate-transfer (BOT) and similar contracts. The management of existing facilities is being decentralized to local authorities or divested to private operators or user groups, such as water associations. In the Philippines, for

instance, non-governmental organizations and people's organizations have taken the initiative in providing basic services and facilities. The Government, recognizing its own limitations, has encouraged at a policy level the direct participation of both kinds of organizations not only as complementary and supplementary mechanisms but also as alternative systems for service delivery. Decentralization of government authority and privatization of public activities have similar effects in terms of moving the source of decisions about the design and operation of services nearer to the consumers.

F. Access to credit

42. Like physical infrastructure, the credit infrastructure is commonly thought of as a government responsibility. While there is no inherent reason for the provision of credit to be a government monopoly, governments have a special role in guiding and advising on both the growth of the financial sector and the protection of depositors and investors.

43. Most entrepreneurs believe that lack of credit is a serious constraint. Surveys have shown finance problems topping the list of complaints by entrepreneurs in one country after another. In Hungary, for instance, the problem may be described alternately as banks' unwillingness to extend loans, non-payment or slow payment by State enterprises, and high interest rates. Although many other problems (unsold inventories, low quality, high costs) may be interpreted by entrepreneurs to imply a shortage of funds and there may in many cases be good reasons for their inability to raise all the funds they would like, lack of access to credit is undoubtedly a real problem and in almost all countries ensuring access to credit is given a high priority.

44. Lack of access to credit is partly a problem of lack of access to banks: in Poland, for instance, a wide range of commercial credit services already exists but their market penetration is slight. In 1992, only 5 per cent of registered businesses had a bank account, compared with 40 per cent in England during the Industrial Revolution. Large enterprises in urban areas have access to banks but State commercial banks commonly exhaust their financial resources by continued lending to bankrupt State firms.

45. There is also the problem of banks providing differential treatment to small enterprises. Informal and small-scale formal entrepreneurs rarely get formal-sector credit, partly because of the relatively high transaction costs for small loans and partly because their lack of reserves and single-project focus make them much more risky than well-established and diversified firms. Small-scale entrepreneurs lack collateral security for loans, or equity, or both. Even for established medium-size enterprises there is a lack of capital, especially long-term capital and more especially venture capital. Mandatory quotas and subsidized interest rates for lending to small firms have been tried in some countries but are not sustainable where they are not in the financial interest of the bank.

46. The lack of debt capital for small businesses may be due to mistaken interest-rate policies. More loans would be made if inflation were controlled and if interest rates were deregulated so that finance institutions could charge

higher rates to compensate for the higher costs and risks. The rates charged in informal markets are usually far higher, so that there is plenty of market opportunity.

47. In some countries, new forms of partnership and agency between branch banks, mobile banks, informal saving/investment schemes, grass-roots organizations and other sources of credit, such as village moneylenders, are increasing the range of access to credit. Such organizations and individuals have a closer knowledge of borrowers and can reduce appraisal and supervision costs and risks. Grass-roots organizations in which the borrower is a member can provide group guarantees that their members will honour their debts: in the famous Grameen Bank programme in Bangladesh, despite the poverty of the borrowers and the lack of tangible security, the repayment rate is over 97 per cent. In this way, international financial institutions, which lend in millions of dollars, can reach micro and small enterprises whose needs are typically in the $100-1,000 range, where local resources are insufficient.

48. In many countries, the focus is on the development of a capital market to mobilize funds, especially domestic savings, for productive investment. In some countries, a new banking system is required. In others, banks need to re-examine their credit risk assessment and credit allocation procedures. Some banks have been severely affected by mounting overdue payments, so that their net worth is now negative. Refinancing by the central bank of commercial bank loans and credit guarantee schemes whereby part of the risk can be insured, also promote entrepreneurial development. Training, technical assistance, recapitalization and prudent central bank supervision help to strengthen banking institutions.

G. Information infrastructure

49. We are living in the early stages of the information revolution, which has been compared with the agricultural revolution of 8,000 BC and the industrial revolution of the eighteenth to twentieth centuries in terms of its impact on our way of life. Information is the basis of all economic activity and the private sector has a vital role in its development, a role, however, that is shared with Governments because of the externalities and non-exclusive characteristics of information, which can be used repeatedly without being consumed. The proliferation of information channels and networks throughout the world, as well as the dramatic reduction in the cost of storing and transmitting information, have opened up scarcely imaginable opportunities for entrepreneurial development.

50. The role of government, apart from physically providing telecommunication networks, as mentioned above, is to use its inherited databases and its official access to information services from other countries and the international community to channel to its entrepreneurs information on such subjects as markets, especially foreign markets, and technology. While large enterprises can obtain relevant information for themselves, small entrepreneurs may not know what information is available, how to search for it or even what information they need. Government programmes for export promotion, small and medium-size enterprise development, incubators, 2/ industrial parks, and the promotion of

information support institutions (chambers of commerce, patent offices, technology and training centres, and professional and technical associations) are directed towards the provision of relevant information to entrepreneurs and the networking of entrepreneurs with sources of support.

H. Access to technology

51. The contribution of technological infrastructure to longer-term economic prosperity is widely accepted. Research and development commitment has a central place in any national programme for promoting entrepreneurship. In developed countries, public and private research institutes and universities have served as a breeding ground for entrepreneurs and start-up high technology companies. The management of technology transfer requires organization and skilled technical manpower; in the absence of domestic skilled manpower, such technology is often imported at excessive costs and is often inappropriate for the situation.

52. Technological policy should be seen as a necessary complement to industrial restructuring and competition policy. The possible benefits from a well-constructed technological policy are great, especially for the needs of small and medium-sized firms and should be closely tied to priority sectors. One way that governments can contribute to technological development is by encouraging technology parks, export processing zones, incubators and industrial estates, with initiative from the private sector.

53. The continuing expansion of the technological gap between developing and developed countries and the evident inability of developing country governments to close this gap by themselves have spurred the acquisition of foreign technology, in such ways as through joint ventures with transnational corporations. The development of technology has been a priority in the newly industrialized countries and certain other developing countries. Governments have initiated and been directly involved in policies for the acquisition/adaptation of technology, the indigenous development of technology, and its dissemination and assimilation. The management of technology transfer requires capability-building in technology acquisition and negotiation. In their absence, inappropriate technology is acquired at an excessive cost, it is inadequately modified to fit the environment, it is not assimilated, and as soon as the vendors leave the technology is likely to become inoperable.

54. Many countries in Asia, such as Japan, the Republic of Korea and Singapore, have supported intensive production-oriented research and development to assist in the development of high-technology enterprises. Public research institutes and universities serve as a breeding ground for entrepreneurs only if there is a close association with private industry. This is facilitated by personnel policies that encourage private consultancy and personnel exchanges between public institutions and private firms.

55. Worldwide, 75 per cent of industrial/scientific information is accessible only through patent literature. National patent offices, which have traditionally limited their functions to the registration and issue of patents,

may be restructured so that they offer a service to entrepreneurs in the provision of technological profiles.

I. Information on markets

56. Entrepreneurs frequently have problems in marketing their products due to lack of market information. Widely disseminated information is equally critical for domestic markets and foreign markets. In Tanzania, newspapers and the radio station broadcast prices of agricultural products by region, which has reduced market inefficiencies in the purchase and distribution of food items. Some countries, such as Poland, are building an information network of databases to provide up-to-date information needed by small businesses. Similarly, Hungary is establishing business centres not further than 30 km from every city: these regional centres will provide advisory, research and educational programmes.

III. REGULATION

57. Regulation of private-sector activity by Governments serves to correct for market weaknesses and to protect vulnerable groups who are unable, in certain situations, to look after themselves. Such groups include customers/consumers, investors/creditors, users of the physical environment and employees. The present paper looks at the protection of those groups in the context of a shift of business activity to the private sector.

A. Protection of consumers

58. Consumers have been a vocal pressure group against privatization, since they fear price increases due to the ending of consumer subsidies and to unrestrained monopoly sectors. They also fear the lowering of quality standards by firms having only bottom-line criteria and the loss of access to services that cost more in remote areas.

59. All those fears relate to monopoly industries where the consumer has no choice of supplier. In developing countries, even after deregulating industries formerly reserved for State enterprises, monopoly is widespread - domestic markets are small, export opportunities are undeveloped and economic plant sizes are relatively high. In practice, many developing country products and services are de facto natural monopolies long after they have been demonopolized in more advanced countries.

60. Governments have tended to postpone facing this issue because they have been more concerned with attracting investors: even where lip service is given to the control of monopolies, little is being done to make it effective. It is widely agreed by economists that competition is the best form of regulation, since competitors control both prices and quality without impeding innovation, technological development and expansion, at no cost to the public purse. Moreover, all markets for importable goods can be demonopolized by liberalizing imports, given time for adjustment.

61. There remains the problem of how to regulate the non-tradeables (electricity, roads, railways, harbours, airports, telecommunications, water, construction and high weight/value products, such as cement) pending the development of competition. It is generally found to be politically necessary to impose price caps on monopolies, while insisting on quality standards and the spread of access to services. On the other hand, there is a school of thought, exemplified in the experience of New Zealand, that treats monopoly regulation as a deterrent to the entry of competitors into an industry and prefers to encourage competition by allowing high profits at least temporarily. The theory of contestable markets - that monopolists are constrained by the possibility of competition where entry into the market is easy - does not apply to natural monopolies, but the theory of regulatable markets - that monopolists may be constrained by the possibility of government regulation - would apply to natural monopolists also. Evidently, decisions on privatization should not be separated from decisions on regulation and on trade policy (Heald, 1988).

62. Some monopoly sectors may be controlled by franchising. A franchise may be awarded to the producer offering the lowest price to customers for a given quantity and quality of the service. Competition is for the market rather than within the market. Of course, there has to be a sufficient number of potential producers to make competition effective. Franchising has a long history in the water industry in France and Spain, and has recently been extended to the power, solid-waste and telecommunication sectors in such countries as China, Guinea, Hungary and Mexico. Recently the city of Buenos Aires awarded a water concession to the company offering to provide water at the lowest rate, which happened to be 20 per cent lower than the rate previously charged by the State-owned water company. The system requires good contract design, capable procurement and effective monitoring. The main problems are on adjustment of prices for unforeseen changes in conditions and the transfer of long-lived assets between successive franchisees (Dnes, 1995).

B. Investor protection

63. The late 1980s has seen the introduction of new securities legislation designed to provide for increased transparency in securities trading, increase disclosures to investors and creditors through the adoption of generally accepted accounting and auditing standards, and limit the extent of insider trading. In countries where there are no formal markets in equities, proposals for the establishment of a stock exchange and development of a stable capital market are combined with regulatory schemes of varying formality. The 1980s have witnessed a rash of developments in capital-market regulation in the smaller economies, derived from broad moves towards liberalization of the financial sector.

64. The financial sector in many developing and transitional countries consists of:

(a) A dominant non-securities sector, with well-established commercial banks, development financial institutions (DFIs) and specialized banks for housing, industry and agriculture, as well as some non-bank financial institutions;

(b) An emerging securities market that has a stock exchange but in terms of total funds raised is insignificant relative to the non-securities sector;

(c) Some form of a money market, with a central bank and commercial banks;

(d) A fairly significant informal or kerb market.

65. In most countries, except the countries of Eastern Europe, the non-securities market has been an important segment in the initial stages of capital market development. The DFIs and specialized banks have been the most important medium and long-term lenders. Notwithstanding their achievements, DFIs have been heavily influenced by government policies, which has contributed to a host of operational problems, significant loan arrears, and deficient credit analysis and monitoring policies. DFIs have had the difficult task of providing subsidized loans to risky ventures and inefficient public enterprises, often forcing governments to recapitalize them with financial transfers from an already overburdened government budget. If DFIs were allowed greater operational and funding flexibility, they could raise funds in the market-place through bonds and syndicated loans etc. Most countries have nationalized commercial banks, which have the same problems as other public-sector enterprises.

66. Many governments are now liberalizing the banking sector, allowing foreign banks to participate and denationalizing their own banks. Non-bank financial institutions, such as leasing companies, merchant banks, venture capital firms, insurance companies and pension/provident funds are much smaller and newer, have a limited capital base and are subject to numerous government operational constraints.

C. Environmental protection

67. The environmental impacts of privatization are a relatively neglected area of study. While environmental impact assessments have become almost standard practice in feasibility studies for major physical investments, little corresponding attention has been paid to the environmental consequences of disinvestment. In East Germany, many of the enterprises that were sold by the Treuhandanstalt (THA) were engaged in heavy pollution industries using out-dated technology installed in an era that was less environmentally conscious. In each case, the buyer was required to use environmentally friendly technology and negotiated with THA the responsibility for clean-up of past contamination, with a corresponding reduction in the take-over price of the enterprise. It is evident that, where environmental standards are evolving and past contamination may be made a liability of the privatized enterprise, the valuation of such liabilities is uncertain: bidders will either be inhibited altogether or reduce their offers to reflect the risk as they perceive it.

68. The traditional command-and-control approach to environmental regulation is being slowly replaced by market-based mechanisms in which regulators set standards, measure results and tax polluters on shortfalls from standards but do not select or enforce particular technologies. The Environmental Protection Agency of the United States Government is developing a pollution trading market

that will encourage firms to trade their pollution liabilities to firms that are more cost-efficient in meeting them. In world terms, the best prospects for reducing global warming may lie in modernizing the production of electricity in countries where power plants burn coal inefficiently. Environmental economists expect that there will have to be international trading of environmental obligations under international agreements.

D. Protection of labour

69. The problem of employment arises from the fact that State enterprises, like civil service cadres, have long been used as political instruments. Excess staff often amount to 50 per cent or more of all staff. Bidders claim the freedom to employ or not to employ staff in accordance with their own business plans, subject only to the general labour laws of the country. There is thus a strong presumption that the short-run effect of divestiture will be to reduce employment, although if the efficiency gains are large enough, the longer-term outlook is for more employment as the firm expands.

70. Some Governments, notably those of Pakistan, Malaysia and Sri Lanka, have conditioned sales on the retention of all staff (except on grounds of gross indiscipline) for a stipulated period; they have been willing to accept the lower sale prices that this entails. This appears to work where the new owners have freedom to redeploy employees flexibly and where the enterprise expands and is able to absorb the excess within a short time, as happened in the Malaysian electricity and telecommunications utilities. In Latin America and Africa, the preferred remedy has been social safety nets, which can combine pre-retirement counselling, assistance in job-finding, links with retraining schemes, and severance payments intended to allow recipients to set up micro-enterprises of their own. Safety nets have been financed by the enterprises themselves (in so far as they are legally liable for compensation), by governments (from privatization proceeds) and in some cases by external donors.

71. Another response to labour opposition has been to allocate shares of equity in the privatized enterprise either free or at a discounted price. If the enterprise has profit expectations, this is attractive to employees and promotes their cooperation. The overall gains in welfare are more equitably spread. On the other hand, the compensation to those who lose their employment is unlikely to be equal to the present value of the difference in the resulting streams of income: they are still the losers in a game in which it is theoretically possible to make everyone a winner.

IV. REDUCING THE ECONOMIC DRAG OF INEFFICIENT PUBLIC ENTERPRISES

A. Privatization

72. The 1980s have seen a reassessment of the role of public enterprises (PEs) in the development process. The economic crisis of the 1980s sparked research on the impact of PEs on the economy, which confirmed the thesis that PEs were in general a principal contributor to fiscal deficits, both on current account and overall, and to balance-of-payments deficits, despite their receiving greater

protection than the private sector and despite the monopoly position that many held (Short, 1983). Seen originally as a key factor in stimulating rapid economic growth, the PE sector is now viewed by many observers as a constraint on economic development. In part, this has emerged as one element in the general shift in the dominant development paradigm. It also stems from a concern about perceived weaknesses in the economic and financial performance of the PE sector in third world countries (Adhikari and Kirkpatrick, 1990).

73. In the recession of the mid-80s, several debtor countries became subject to programmes of structural adjustment that offered balance-of-payments relief in return for changes in domestic policies that would restore their creditworthiness. Foremost in the general prescription was the sale of public enterprises into private hands or, where enterprises had no viable future, their outright liquidation. It is probably true that most privatization programmes have been driven mainly by the prospect of getting the losses and capital needs of State enterprises off the government budget and replaced by proceeds of sale.

74. Concurrently, there has been a Hayekian revolution in attitudes towards the respective roles of the State and the private sector, and the generally superior efficiency of resources in private hands. Standard microeconomic theory says nothing about the effects of alternative ownership structures: property rights theory applies equally to managers of public enterprises and to managers of private enterprises where ownership is divorced from management. Empirically, the comparative performance record of public and private enterprises is mixed, especially with regard to monopolies (Vickers and Yarrow, 1988, p. 40). The Asian success stories of Japan, Hong Kong, the Republic of Korea and Singapore are often cited as favourable examples of public sector efficiency and of the interventionist role of governments. These role models are being emulated by Malaysia, Thailand, Indonesia and Viet Nam.

75. The financial performance of enterprises after privatization has generally been found to be better than before, although it is frequently observed that the improvement is attributable either to higher prices or to the incentives of greater competition in the relevant markets. It is probable that the change of ownership of equity in itself has a relatively minor effect. In many successful privatizations, Government has not sold more than a minority of its equity, as for instance in the Malaysian telecommunication and electricity utilities. Nevertheless, a major objective in privatization programmes has been the improvement of the efficiency - meaning financial efficiency as a surrogate for economic efficiency - of State enterprises. This has been the justification for the privatization of profitable as well as unprofitable enterprises.

76. At a recent conference in Buenos Aires reviewing Latin American experience with privatization, it was observed that privatization had been too much concerned with short-run fiscal effects and had not sufficiently concentrated on the improvement of efficiency. The latter was seen as the key to international strength and competitiveness.

77. Swanson and Wolde-Semait (1989) reviewed the experience in African countries that had been assisted by the World Bank and concluded that the expansion of the PE sector that had occurred in the 1970s and early 1980s had decelerated since 1985. They found that some privileges enjoyed by PEs, notably

monopoly rights and lax budgetary and financial discipline, had been reduced, that the flow of information between governments and PEs had improved, and that financial losses had been reduced in a majority of those countries that showed a trend. However, the underlying problems had not been fully addressed. Divestiture, for instance, had been confined mainly to small PEs and financial transactions lacked transparency. Although direct government payments to PEs were declining, PEs were obtaining more credit from the banking sector and governments were still faced with the problem of bad debts.

78. In the poorer developing countries, rhetoric has outstripped reality and the impact of privatization so far has been to deter the creation of new public enterprises and to harden the budgets of existing enterprises, rather than to bring about outright divestiture or liquidation. Privatization has often been politically unwelcome because of the loss of patronage that it entails and governments have been reluctant to meet the conditions laid down by the international banking system. Even where there has been wholehearted commitment by governments, privatization by outright sale has proved to be difficult and fraught with problems, such as finding buyers, preferably buyers who will exercise effective and wise governance, where savings rates are low; minimizing the social dislocation resulting from large numbers of retrenched staff; and problems related to valuation. It has been difficult for governments to accept and write off the enormous losses laid bare by low sale values compared with historic investment; actual revenue proceeds have often been negligible.

79. The likely time-frame of privatization in each country varies according to the size and diversity of the public sector, the political urgency of reform and, in indebted countries, the degree of pressure brought to bear by the multilateral financial institutions. The level of domestic savings and foreign investment may also be determining factors, since the value of public enterprises to be sold may require a high proportion of available savings for several years; however, the importance of those considerations is lessened where governments recycle privatization proceeds back to the private sector, or where they simply give the PEs away on an equitable basis, as in the voucher systems of several transitional economies.

80. The correct sequencing of reform is also very important. In most developing countries and the new East European nations, a stable macroeconomic structure must precede liberalization, which in turn must precede privatization. Market-friendly reforms are an urgent first step in support of private enterprise and decentralized decision-making.

81. Non-divestiture options include the privatization of the management of government resources through various forms of contract, such as management contract, performance contract, lease, concession and so on. 3/ A further set of options are concerned with the private-sector financing and implementation of (usually infrastructural) projects that would formerly have been considered a government responsibility, such as build-operate-transfer (BOT) contracts. Such non-divestiture options have the advantage of avoiding the problems of valuation and finding buyers. They appeal to governments that are afraid to hand over responsibility for strategic enterprises that have (or are supposed to have) important social dimensions. They also appeal to governments who feel that popular understanding and support for outright divestiture has not yet emerged;

such governments use these mechanisms as interim strategies to improve performance pending the development of wider political consensus.

82. On the other hand, non-divestiture options are difficult for a developing country government that is short of technical skills for planning and monitoring. All forms of contract require careful specification of what is to be done (goals, performance indicators and targets), definition of the authority and responsibility of the contractors, formulation of performance-linked incentives, and monitoring and evaluation systems to ensure that contracts are discharged as intended.

83. The potential for contracting out specified activities is investigated by market testing, i.e., inviting bids. An important early lesson is that where private firms are invited to compete with public-sector authorities, the specification of tenders and evaluation of bids should be made by a section that is both technically competent and independent of the operations department, a difficult lesson for developing countries in which technical skills are scarce and likely to be found only in the monopoly operator. A similar problem applies in drawing up management contracts with outside firms or performance contracts with incumbent management teams.

84. It is often observed that privatization is essentially a political process that has profound social and economic effects. Entrenched interests benefit from the long-established status quo. Sustained economic reform requires new political constituencies with stakes in the reformed system. In China, Deng built his reforms on the basis of new private incentives in agriculture; in Argentina, Menem used the telephone companies and Yacimientos Petrolíferos Fiscales. Political leaders like Thatcher, Menem and Salinas were not elected with mandates to undertake privatization; this became their governments' trademark only after they came to power. Nevertheless, with or without a popular mandate, the success of privatization depends on strong political champions.

85. Four aspects of privatization have been relatively neglected in its first decade and are now getting more systematic attention: the consumer impact; the environmental impact; the employment impact; and transparency. The first three aspects have been reviewed in section III above; the fourth is considered below.

B. Transparency

86. In the initial rush to privatize, governments have paid insufficient attention to the need to account publicly for their decisions and actions. This tendency has been reinforced by the undoubtedly opportunistic behaviour of some politicians and bureaucrats, who have found themselves in unaccustomed positions of power with regard to the disposal of State assets. One of the motives behind the divestiture movement has been so-called crony capitalism, from which the relatives, friends and supporters of members of the ruling group have been the chief beneficiaries (Killick and Commander 1988). The desire of governments to deflect political criticism often impels them to conduct negotiations secretly behind closed doors, where corruption multiplies.

87. In many countries, there are no financial regulations on privatization procedures, since the need was never envisaged at the time they were framed. Privatization codes of conduct, such as the use of sealed bidding procedures, have tended to trail behind the initiation of programmes of privatization instead of preceding them. It is becoming accepted that the sale of enterprises requires at least the same degree of transparency and public accountability as would apply to acquisitions on the same scale.

88. In the ex-socialist economies, there has been a similar lack of transparency in the so-called spontaneous privatizations. Workers and managers have taken advantage of the ambiguity inherent in the concepts of social ownership and worker management and the decentralization of operating autonomy and appropriated enterprise assets to themselves. Central privatization agencies are also not above suspicion (see Privatization International, No. 11, 1991).

89. The drive to privatize creates a danger that privatization may become an end in itself, irrespective of any increases in efficiency or any other benefit. Purchasers of enterprises may extract from a government under pressure concessions that negate any efficiency gains or even fiscal gains. A clear policy declaration that the terms of any proposed privatization will be disclosed for public scrutiny would result in major gains in many countries. Audit institutions should examine critically the terms of each privatization sale against the stated objectives of the exercise.

90. At a meeting of European supreme audit institutions in Prague in 1992, it was stated that auditors tended to assume that the main objective was maximum fiscal revenue in the absence of clear policy statements to the contrary. There was no mention of economic efficiency audit, even where the Government's declared objective was to increase efficiency, but this probably reflects the general lag in the development of comprehensive audit. This comment would apply *a fortiori* to the transitional countries, in which audit is being adapted to new constitutional requirements, and to developing countries, which are in general still struggling with inadequate staff to extend the coverage of simple regularity audit.

V. ROLE OF TECHNICAL ASSISTANCE

91. Public-sector restructuring is a complex and demanding reform, requiring both a high degree of administrative capacity and technical know-how that is not readily available in many developing countries. Transitional countries frequently lack understanding of corporate financial and marketing management and the institutions of a market economy, particularly the capital market institutions. Starting with analysing the condition of public-sector activities, the reform agency must first test the receptivity of the private sector and prepare the activity for takeover. Before divesting an enterprise, the agency must decide if the Government should first restructure its finances, or retrench surplus staff. If the enterprise was formerly privately owned, should the Government assume responsibility for the residual claims after the change of ownership? What about environmental liabilities? Should the new ownership be totally private or only partially so? Should the process of

privatization be immediate or phased and should foreign ownership be allowed or restricted? The agency must identify the target ownership, establish a value for the enterprise, price the equity shares, market the enterprise to the new owners and judge the ability of the capital market to absorb the issue without unduly crowding out other issues.

92. All the above-mentioned tasks imply the creation and strengthening of institutions that can administer such special programmes. One critical task is to establish organizations and agencies that can provide technical and financial assistance. International agencies are now committing resources for such institution-building and providing technical assistance. The organizations and bodies of the United Nations system, including the Department for Development Support and Management Services of the United Nations Secretariat, the International Labour Organization, the United Nations Development Programme (UNDP), the United Nations Industrial Development Organization and the United Nations Conference on Trade and Development, as well as the World Bank, the International Monetary Fund (IMF), the European Bank for Reconstruction and Development, the Asian Development Bank, the African Development Bank, the Inter-American Development Bank and bilateral donors, such as the United States Agency for International Development (USAID), are all working with various government and non-governmental organizations to provide such technical and financial assistance.

93. There is an increasing willingness to provide assistance to non-governmental organizations, since they often have a good understanding of the local environment, easy access to intended beneficiaries and a willingness and ability to finance and use low-cost technologies.

94. While the United Nations and specialized agencies have generally focused more on technical assistance, the World Bank participates in direct financing through the International Finance Corporation (IFC), whose mandate is to catalyse private-sector activity. IFC is normally exposed to full project risks and has a mandate to do business that is both financially sound and of economic importance. Through its newest affiliate, the Multilateral Investment Guarantee Agency (MIGA), the World Bank provides guarantees against non-commercial and political (country) risks to encourage foreign-direct investment. The regional development banks often participate in financial ventures themselves to boost initial institution-building. USAID and IMF are involved in various financial reform packages. The challenges are numerous and the available resources are limited.

VI. LOOKING INTO THE TWENTY-FIRST CENTURY

95. First, despite a deceleration in world growth in the 1980s and the continuing listlessness of the world economy in the early 1990s, there has been a marked trend towards the internationalization of trade and investment and the increased share of trade and output accounted for by transnational corporations (TNCs). The number of TNCs based in the developing countries is increasing faster than the number based in the developed countries, in line with the faster overall growth rates in their countries of origin, although they still account for only a very small share of global totals. This trend has a great momentum

and it is difficult to conceive of events that could halt or reverse it in the near future.

96. Second, globalization has been associated with extraordinarily rapid advances in information technology and the development of the information super-highway (the Internet, World Wide Web etc.). Communication via the Internet to any point in the world now costs no more than a local telephone call. However, the great majority of persons do not even have telephone service; the first priority in most countries will be higher rates of telephone penetration.

97. The third major trend in the global economy is the main theme of the present paper: the transfer of microeconomic decision-making out of government agencies and into private and joint public-private organizations of various kinds. More broadly, this could be called marketization - establishing a greater reliance on free markets - because it involves approaching economic decisions in terms of surplus maximization within market pressures of supply and demand rather than in terms of administrative policy.

98. The collapse of the centrally planned economies and their transformation by privatization is one aspect of the marketization process. The trend to decentralize decision-making away from government hierarchies so that decisions are made more sensitive to grass-roots demand - as exemplified by the increased power of provincial, township and village authorities in China - is another aspect of the same process. A third aspect is the trend, so far more marked in the developed economies, of involving customers in decisions on the design and delivery of products and services by various participatory mechanisms. Customer feedback will be facilitated by interactive communications now in the experimental phase. The standardization of products to obtain economies of scale is being challenged by the development of flexible manufacturing methods that standardize processes instead and thus enable producers to meet individual specifications economically, as is already the practice in the personal computer market.

99. The rate of divestiture appears to be increasing. In terms of total proceeds, privatization doubled from $25.3 billion in 1990 to just under $50 billion in 1991 (See Privatization International, January 1992). Capital market constraints and valuation problems are being solved or avoided altogether by innovative methods currently being experimented with (see, for example, Ellerman and others, 1991, and Savas, 1991). According to the UNDP Interregional Network on Privatization, privatization became an increasingly important instrument of public policy in the 1980s and can be expected to become even more important in the future (UNDP, 1991). World Bank staff agree: Galal (1991, p. 26) points to the many governments around the world that are increasingly examining the role of the State, predicting that questions of both reforming enterprises and divestiture are likely to intensify rather than diminish in the near future. Lee and Nellis (1991, p. 115), after reviewing the reform experiences of seven socialist and transitional economies, conclude that despite the legal/legislative struggle over property rights clarification, privatization is necessary to produce a supply response that is strong enough to generate entrepreneurs, investors and dynamic management. The emphasis on the private sector is likely to continue to grow; gains in social welfare, however, will depend on careful planning and responsible implementation.

/...

Notes

1/ Public enterprises are defined as government-owned or controlled organizations, in any legal form, that provide goods and services to the public (IMF, 1986).

2/ An incubator is a firm that provides business premises and shared services (secretarial, clerical, receiving/shipping, conference rooms, computers, consultancy) to new businesses starting up, usually for a limited period, for a fee. There are two kinds of incubators: in-company or corporate incubators and community or region-based incubators.

3/ These options are usually combined with corporatization, i.e., the legal and financial separation and autonomy of the enterprise from the government.

References

Adhikari, R., and C. Kirkpatrick (1990). Public enterprise in less developed countries. In Public Enterprise at the Crossroads, John Heath, ed. London: Routledge.

Dnes, Anthony W. (1995). Franchising and privatization. In Public Policy for the Private Sector (June). Washington: World Bank.

Ellerman, David P., and others (1991). Decentralized privatization: the Slovene ESOP programme. In Public Enterprise, vol. 11, Nos. 2-23. Ljubljana: ICPE.

Galal, A. (1991). Public enterprise reform: lessons from the past and issues for the future. World Bank Discussion Paper, No. 119.

Heald, David (1988). The relevance of UK privatization for LDCs. In Paul Cook and Colin Kirkpatrick, eds., Privatization in Less Developed Countries. Hemel Hempstead: Wheatsheaf.

International Monetary Fund (1986). A Manual on Government Finance Statistics. Washington, D.C.

Killick, T., and S. Commander (1988). State divestiture as a policy instrument in developing countries. In World Development, No. 16.

Lee, B., and J. Nellis (1991). Enterprise reform and privatization in socialist economies. World Bank Discussion Paper, No. 104.

Savas, E. E. (1991). Structural transformation in post-socialist countries: the privatization of State-owned enterprises. In Governance and Structural Transformation in Transitional Economies, report of a United Nations meeting on the problems of economies in transition, Moscow, 22-26 September 1991. New York: United Nations.

Short, R. P. (1983). Paper in Public Enterprise in Mixed Economies, R. H. Floyd, C. S. Gray and R. P. Short, eds. Washington: International Monetary Fund.

Swanson, D., and T. Wolde-Semait (1989). Africa's public enterprise sector and evidence of reforms. World Bank Technical Paper, No. 95.

United Nations Centre on Transnational Corporations (1988). Transnational Corporations in World Development: Trends and Prospects. New York: United Nations.

United Nations Development Programme (1991). Guidelines on Privatization. New York: United Nations.

Vickers, John, and George Yarrow (1988). Privatization: An Economic Analysis. Cambridge, Massachusetts: MIT Press.
