

## Privatising the Third World

A remarkable feature of recent economic policy in many Third World countries has been the adoption of privatisation and deregulation by previously "statist" governments. Assets sales are one aspect of this. The denationalisation of state enterprises has begun or is promised in a wide variety of LDCs. In Asia: since 1982 Bangladesh has sold off enterprises in jute, textiles, chemicals and engineering. The proportion of industrial assets in state hands is now less than half that in the early 1970s. Similarly Pakistan has privatised rice, flour and cotton mills. In South Korea banks were denationalised four years ago; in Hongkong the telephone system was recently sold to Cable and Wireless.<sup>1</sup> In Latin America the same trend is evident. Mexico, Peru and Argentina have put state-owned industrial firms up for sale. In Brazil 'destatisation' has involved the divestiture of around thirty state enterprises of various sizes, with many more in the pipeline.<sup>2</sup> Even in Africa, eleven nations are reforming or divesting state firms. A Nigerian spokesman has said that 'privatisation is a foregone conclusion'. Togo appointed a leading businessman to speed the privatisation programme while Sierra Leone has sold a number of assets to Lebanese entrepreneurs.<sup>3</sup> Where outright sales of nationalised enterprises are rejected the state's role in the economy is often reduced by closures of loss-making activities, cuts in employment in overstaffed areas and the introduction of private sector funding through share (an example is Brazil's Petrobras) or bond issues.

Perhaps more fundamentally, this process is being accompanied by measures to liberalise markets and encourage competition. This is something which goes right against the ideal of centralised planning which has been such a powerful influence on development thinking for

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<sup>1</sup> These are just some examples from a long list. See D. WILSON 'The Privatisation of Asia', *The Banker*, September 1984.

<sup>2</sup> See 'Privatisation: everybody's doing it, differently', *The Economist*, December 21, 1985.

<sup>3</sup> See A. KALETSKY 'Everywhere the state is in retreat', *Financial Times*, August 2, 1985 and T. HAWKINS 'Time for a new initiative', *Financial Times*, May 27, 1986.

much of the postwar period. Thus we are seeing the abolition of state monopolies in such fields as transport (Kenya, Tanzania) and agricultural marketing (much of Africa), the relaxation of price, output and credit controls and reductions in taxes (India<sup>4</sup> is a good example; so, in a different way, is China).

These common tendencies are so marked across the Third World that they require some form of explanation. Some may see them as a reflection of the policies adopted by pro-market governments in the Developed World and their representatives in international agencies such as the IMF and the World Bank.

Certainly many publications from international organisations in recent years have stressed the virtues of privatisation and liberalisation in authentic Thatcherite or (more importantly) Reaganite terms.<sup>5</sup> However it would be a mistake to see these policies simply as being imposed by rich countries against the interests and inclinations of the LDCs. For there seem to have been genuine changes of attitude towards the state's role in the economy in many Third World countries, as the expectations and hopes of the past are seen to have been exaggerated.

### The State in Third World Economies

The degree of state involvement in parts of the Third World greatly exceeds that found in most non-communist developed countries, and it is certainly greater than was the case when today's rich countries were at comparable levels of development. One indicator of this is found in employment statistics: whereas total public sector employment averages about 24% of all non-agricultural employment in OECD countries, it averages about 44% for developing countries.<sup>6</sup> Even as a percentage of total population (in countries with very large agricultural sectors), public sector employment in the Third World is high by historical standards. But apart from direct state involvement in the economy,

<sup>4</sup> See BARNETT R. RUBIN 'Economic Liberalisation and the Indian State', *Third World Quarterly*, October 1983, and T. CONGDON, 'A massive move back to market', *Financial Weekly*, March 6, 1986.

<sup>5</sup> Some samples: *Public Enterprise in Mixed Economies: Some Macroeconomic Aspects*, IMF, Washington, 1984; H. HUGHES, 'Private enterprise and development', *Finance and Development*, March 1982; S. PAUL 'Privatisation and the Public Sector', *Finance and Development*, December 1985.

<sup>6</sup> See P. HELLER and A. TAIT 'Government employment and pay', *Finance and Development*, September 1983. Note that African countries have the highest proportion of public sector employees in the non-agricultural workforce at 54%.

regulation and control of private sector activity has been a major feature of (significant term) development planning. Price ceilings, wage regulation, fixed (and usually hopelessly unrealistic) exchange rates and exchange controls, credit rationing, direction of investment, controls on imports; these have commonly been the instruments of governments wishing to accelerate development. Such market regulation may permeate entire economies, not just the 'modern' industrial sector. Agriculture, for instance, may be stymied by state controls over marketing.

Now even in the developed capitalist countries there is substantial state involvement; the term 'mixed economies' is frequently used. Economics textbooks often rationalise intervention in the market by reference to a number of 'market failures' where the conditions necessary for the optimality of private enterprise are not met. Here the government may appropriately step in, to nationalise and/or regulate the activity in question.

For example *natural monopolies* may exist, where the economies of scale are so pronounced that their full exploitation allows room for only one producer in an industry, and some form of state involvement is called for. Or there may be *externalities* arising from production, where the costs and benefits of private activity are not fully reflected in market prices; again government intervention is appropriate. Similarly the state must step in to secure adequate supply of *public goods*, defined as those possessing characteristics of non-rivalness and non-excludability which tend to encourage 'free riders' and thus preclude private provision on the appropriate scale. Defence and infrastructure spending may come under this heading. Then again, the pattern of *income distribution* thrown up by a free market may be regarded as inappropriate and may necessitate intervention.

Using these categories a case can be made out for a high level of state involvement in poor economies. Where markets are relatively small and underdeveloped, natural monopolies will be more of a problem. External benefits from, say, basic education and public health schemes, may be very important. Income disparities are much greater than in developed countries, and so on.

However the actual pattern of state involvement even in the developed world differs so much from country to country that explanations simply in terms of pragmatic responses to market failures seem implausible.<sup>7</sup> This is true *a fortiori* of LDCs where it seems likely that

<sup>7</sup> See J. R. SHACKLETON 'Back to the Market? The Political Economy of Privatisation and Deregulation', *Public Policy and Administration*, forthcoming.

ideological preferences and more specific political consideration have played a major role.

### Ideological and Political Factors

It is undeniable that many Third World leaders have been influenced by socialist thinking (in its myriad varieties) to take a very critical view of private enterprise and the market and to see direct state intervention as the appropriate means of promoting economic development. It may be natural to think of Marxism in this context. However the link between Marxism and statism in LDCs is not an altogether clear one. On some readings of Marx,<sup>8</sup> capitalist development of the Third World is possible, even likely. The export of capital from rich to poor countries as a means of staving off the tendency of the rate of profit to fall might be seen as an equalising force in the world economy. The spread of capitalist relations to new areas might be thought to herald a rise in productivity and impart a new dimension to otherwise stagnant economies. Considerations such as these, for example, led Marx to the conclusion that British rule in India was historically progressive.

On this view a period of capitalist development might seem to be possible, even perhaps a necessary stage in a country's progress. However twentieth-century political developments — most notably the Russian revolution and the subsequent growth of Soviet economic and military power — have led most modern Marxists to conclude that LDCs can skip a stage in the process of economic development. They can move from largely peasant agricultural economies to a stage of state socialism without going through a period of capitalist expansion. Theoretical innovations such as the Latin American inspired dependency theory<sup>9</sup> have suggested that in any case capitalist 'development' of the poor 'periphery' would be limited to that necessary to service the metropolitan centres of advanced capitalism. It would not permit the development of powerful new economies capable of challenging the existing capitalist order.

<sup>8</sup> Of course there are others. See for example DAVID F. RUCCIO and LAWRENCE H. SIMON 'Methodological Aspects of a Marxian Approach to Development: An Analysis of the Modes of Production School', *World Development*, Vol. 14, No. 2, February 1986.

<sup>9</sup> See, for a discussion of one major contributor to this theory, LAWRENCE H. SIMON and DAVID F. RUCCIO 'A Methodological Analysis of Dependence Theory: Explanation in Andre Gunder Frank', *World Development*, Vol. 14, No. 2, February 1986.

Even the more moderate traditions of European social democracy have had an impact. There is no doubt, for instance, that the Fabianism absorbed by many Indian political figures forty or fifty years ago had a considerable influence on the type of economic policies followed after Independence.

But ideology is surely one factor amongst many. More pragmatic considerations have also led Third World governments to place great emphasis on the state's role in development. For instance, the need to raise government revenue in countries with a limited tax base has in the past led to the establishment of state monopolies in key commodities such as salt and tobacco. The process of nation-building and the need to establish a clear independent identity has sometimes led to an unhealthy fascination with status symbols. Examples include international airlines (almost inevitably uneconomic and thus having to be state-run or subsidised), or what the World Bank has called 'ostentatious universities, overdesigned highways, luxury sports stadiums and uncompetitive agro-industries'. Unfortunately, too, nationalisation and regulation have often been means of discriminating against ethnic minorities who would otherwise dominate free markets — Chinese in South East Asia, Asians in East Africa.

The emphasis on state involvement in the economy has also been enhanced by the desire to attract foreign aid. In principle governments could simply act as a conduit between aid donors and private enterprises seeking investment funds. In practice Third World governments have, for fair reasons and foul (such as the desire of bureaucrats to cream off resources into their own pockets), usually been closely involved in the allocation and the spending of aid. This tendency has often been accentuated by the ambivalent motives and attitudes of donors. In the case of tied aid, donor governments are giving aid with the condition that goods are purchased which would otherwise not have been purchased by private firms. This is already an interference with market forces; it has all too often led aid recipients to make inappropriate and uneconomic choices of products and techniques. More generally, donor governments and agencies are staffed by bureaucrats who feel more at home talking to a recipient government's bureaucrats than to Third World entrepreneurs — where there may be much more marked divergences of language and cultural values.

Moreover we should remember that in too many cases colonial powers had suppressed or at least failed to encourage the development of an independent native bourgeoisie; entrepreneurial and managerial

skills were often diverted into government employment, from which it has proved very difficult to dislodge them. In any case the 'enterprise ethic', which so many analysts of capitalism from Max Weber to Margaret Thatcher have seen as crucial to development, is not necessarily present in all cultures and at all times. Whereas Weber saw Calvinism as a particularly important world view, with its stress on hard work and thrift, some writers have recently tried to argue that Confucianism might be of similar importance in South-East Asia. But where value systems appear to be less consonant with capitalist development, some form of statism may seem inevitable.

### Statism in Practice

For a variety of reasons, then, heavy state involvement in the economy has been a characteristic of Third World countries. How successful has this intervention been? Critics like Helen Hughes of the World Bank claim that 'the evidence suggests that those countries that have grown most rapidly have adopted a policy framework that enables private enterprise to thrive'.<sup>10</sup> Dick Wilson, looking at Asia, points out that the fastest-growing economies in the 1970s were those of countries such as South Korea, Hongkong and Singapore which were oriented towards the market: the slowest-growing were the heavily-statist India, Bangladesh and Pakistan.<sup>11</sup> It could (rightly) be argued that such comparisons are meaningless: the economies in question are so different in terms of size and natural endowments that their relative growth performance may be explained by quite other factors than the state's degree of intervention. It is interesting therefore to look at the findings of Ram D. Singh's recent econometric study.<sup>12</sup> Singh uses data from 73 LDCs to try to explain comparative growth rates. He includes such explanatory variables as economic aid as a percentage of GDP, the domestic savings rate, population size, per capita income, whether or not a country is an oil exporter and so on. But he also includes a 'state intervention' variable — an indicator which reflects the regulatory role

<sup>10</sup> H. HUGHES 'Private enterprise and development-comparative country experience', *op. cit.*

<sup>11</sup> D. WILSON 'The Privatisation of Asia', *op. cit.*

<sup>12</sup> RAM D. SINGH 'State Intervention, Foreign Economic Aid, Savings and Growth in LDCs: Some Recent Evidence', *Kyklos*, Vol. 38, Fasc. 2, 1985.

of the state and its level of nationalisation on a numerical scale. To quote Singh's conclusion: "State intervention significantly reduced a country's rate of economic growth, other things constant... the estimated coefficient on state intervention remained stable across several specifications tried".<sup>13</sup>

What microeconomic factors might account for this poor macroeconomic performance? An element which has been identified is the poor record of state enterprise. One study of 25 developing countries showed that the average overall public sector deficit (before reduction by government current transfers) was 5.5% of GDP in the 1970s.<sup>14</sup> Commenting on this, an observer has written that "in a number of countries the public enterprise deficit has been identified as a proximate cause of excessive credit creation, leading to monetary expansion, price inflation, and, ultimately, to balance of payments pressures".<sup>15</sup> To put this in more concrete terms, the World Bank found in 1983 that a 5% increase in state enterprise revenues and a 5% reduction in costs would be enough to finance the whole of Tanzania's spending on health.<sup>16</sup>

The weaknesses of public enterprise in *developed* countries have been extensively discussed.<sup>17</sup> The possession of monopoly powers, the protection from new entry, the lack of clarity and the inconsistent pursuit of objectives, repeated government interference, unexamined cross-subsidisation, excessive trade union influence: these are some of the explanations which critics of nationalised enterprises have put forward for their poor profit, productivity and growth records.<sup>18</sup> In the context of the Third World we can also add the role which such enterprises frequently fulfil as employment agencies for urban workers. Overstaffing is endemic when existing employees are able to use their influence to obtain jobs for family members.

<sup>13</sup> *Ibid.*, p. 230.

<sup>14</sup> A Study by R.P. SHORT in *Public Enterprise in Mixed Economies: Some Macroeconomics Aspects*, IMF, Washington, 1984. Reported in *IMF Survey*, November 12, 1984.

<sup>15</sup> M. de LAVOSIERE in his Foreword to *Public Enterprise in Mixed Economies*, *op. cit.*

<sup>16</sup> Reported in A. KALETSKY 'Everywhere the State is in Retreat', *op. cit.*

<sup>17</sup> For the UK, a most illuminating treatment is provided by R. PRYKE *The Nationalised Industries: Policies and Performance Since 1968*, London, Martin Robertson, 1981.

<sup>18</sup> Recently echoed by the IMF: "State enterprises have often been vehicles for the implementation of social policy, for example by being forced to locate in particular regions, or being required to hire excessive quantities of labour.... by being required to purchase inputs from domestic supplies or to adopt particular types of technology. While each individual decision usually has a legitimate motivation, their combined effect has been highly detrimental", IMF, *World Economic Outlook*, April 1986, pp. 16-17.

Overstaffing is not confined to state enterprises: clearly the local and national government bureaucracies and the education, health and welfare sectors suffer from the same problem. We have already noted that in some LDCs — notably in Africa — the public sector in total can account for over half of non-agricultural employment. Workers in this sector are often relatively highly unionised and the rates of pay they obtain both constitute a heavy burden on the taxpayer and serve to pull up wages in other parts of the urban labour market, thus worsening the overall terms of trade between the agricultural and non-agricultural sectors. In many parts of the Third World government employees are a distinctly privileged group. According to Peter Heller and Alan Tait, for example, the average central government wage in Africa is just over six times GDP per head.<sup>19</sup>

Inflated levels of government employment are not only a burden on the rest of the economy, they represent a misallocation of much of the best and most highly educated talent to non-productive activities: indeed, often to positively harmful activities. The public sector may come to be seen by many as offering a much surer road to personal enrichment than the dangerous uncertainties of private enterprise. Corruption is endemic in many parts of the Third World. It has been suggested that in LDCs 25% or more of government revenue disappears in corrupt payments — and this is only a partial indication of the scale and significance of corruption. Revenue losses are but one aspect of a phenomenon which includes the illegal sale of licences, allocation of import and foreign exchange quotas for personal gain and the distribution of contracts in return for financial and other benefits. Detailed state regulation of economic activity necessarily throws up opportunities for bribery and corruption<sup>20</sup> which almost certainly have a deleterious effect on economic development.

### Pushing for Privatisation

Against this background, the pressures for privatisation and liberalisation are easier to understand. It is certainly true, as noted earlier, that a good deal of pressure has come from US dominated

<sup>19</sup> P. HELLER and A. TAIT *op. cit.*, p. 46.

<sup>20</sup> For a brief discussion see J.R. SHACKLETON 'Nigeria and the Market for Corruption', *Economic Affairs*, January-March 1985.

international agencies. Recent international conferences on privatisation include those held in early 1986 by the Agency for International Development and the previous year by the Asian Development Bank.<sup>21</sup> In a paper presented to the latter Dattatraya Pendse<sup>22</sup> has pointed to a number of ways in which donor agencies might promote privatisation. A factor adding greater urgency to the issue is the international debt crisis, which means that the massive inflows of aid and other capital transfers which have often largely gone to support uneconomic state enterprises are now drying up.<sup>23</sup> Nevertheless these external forces may be pushing against an open door, as more and more governments of LDCs have come to realise that the results of state enterprise and state regulation have not turned out anything like as well as expected.

It may also be the case that there is a positive response to the comparative success of those economies where the market has been allowed much freer play. Thus the rapid growth of countries like Japan, South Korea and Hongkong is having a 'demonstration effect' on many neighbouring countries which had previously looked for their models elsewhere. There is discernible, too, a new self-confidence amongst entrepreneurs even in previously statist economies. Rather than looking to the state for protection against dominant outside capitalists, entrepreneurs are becoming more outward-looking. One symptom of this is the growth of Third World multinationals. This process began in the 1960s and gained momentum in the 1970s. Perhaps as many as fifty LDCs now have some companies operating abroad.<sup>24</sup>

### Prospects

Given all these factors working towards privatisation and deregulation, what are the realistic prospects for these policies? Do they seem likely significantly to increase efficiency and promote more rapid growth? There seem to be several reasons for caution.

<sup>21</sup> For a surprisingly sceptical view of one of these conferences, see Sir ALFRED SHERMAN 'Why the Americans are exporting their gospel', *Financial Weekly*, March 6, 1986.

<sup>22</sup> DATTATRAYA R. PENDESE 'Some Reflections on the Role of Donor Agencies in the Privatisation Process', *National Westminster Bank Quarterly Review*, November 1985.

<sup>23</sup> See D. NELSON 'Privatisation and World Debt', *Development Forum*, April 1986.

<sup>24</sup> S. LALL 'The Rise of Multinationals from the Third World', *Third World Quarterly*, July 1983.

First, take the question of the sale of state assets. A number of difficulties suggest themselves. Many loss-making state enterprises will be difficult to sell. Those which are currently profitable will be the easiest to dispose of, but governments will be less anxious to do so, particularly where (as may often be the case) they may effectively be monopolies. Anyway, who will buy them? In most parts of the Third World, domestic capital markets are rudimentary. Popular capitalism of the kind exalted by Mrs Thatcher seems a remote prospect; even the use of pension funds to purchase shares is only possible in some of the richer Latin American countries. The most likely outcome is a sale to a handful of rich domestic investors — often closely related to the ruling politicians, and thus laying the government open to accusations of corruption and 'cronyism'. Another possibility is an influx of foreign capital, but even if it is forthcoming in adequate quantities, governments are likely to be wary of this. However there may be opportunities for joint ventures, perhaps with the domestic government retaining a majority shareholding. Such operations would have the extra benefits of giving access to outside technologies and stimulating more export-oriented attitudes.

Second, analysts are agreed that the benefits from asset sales themselves are rather limited without genuine liberalisation which allows new entry into fields which were previously the prerogative of the state. Yet this may be difficult to achieve. Often deregulation will pose major threats to the incomes and jobs those currently employed in protected sectors, and in the nature of things they will find it easier to organise than the as yet inchoate groups which might be prepared to enter. And the benefits in the form of lower prices and greater choice, although significant in total, will in the main be marginal to individual consumers; whereas the loss to existing producers is likely to be large. Even if deregulation is achieved, the results in terms of new entry and product innovation may turn out to be disappointing. Providing the opportunity for entrepreneurship to flourish is not the same thing as being able to guarantee that it takes root. Low savings ratios, inadequate access to capital and education, and the lack of a strong tradition of independent capitalist initiative provide formidable barriers to rapid growth. And workers displaced from one job may find it difficult to obtain adequate reemployment elsewhere. In the longer term, these things may change: but there is unlikely to be an immediate explosion of new capitalist enterprise as the result of a change in government policy,

especially where it is only grudgingly accepted by some and perceived as likely to be reversed in future by others. In any case the precise alchemy linking institutions to economic performance remains unknown. By some measures, for instance, the UK and Italy are more market-oriented economies than Japan and Sweden; but this is not reflected in their economic records.

We must also remember the point touched on earlier — that LDCs are likely to be particularly subject to those 'market failures' which even the keenest advocates of free enterprise recognise as providing a justification for state involvement in the economy. While the current focus on 'government failures' may be a necessary corrective to overoptimistic views of state intervention, there remains an undisputed role for the state in some aspects of infrastructure investment, education, health and welfare. It is also the case that governments will continue — rightly — to be pressed to ameliorate the distributional consequences of economic change.

In view of these reservations, it is not surprising that few Third World governments have gone completely overboard for free market economics *à la* Friedman or Hayek. There *are* examples, of course: Chile is probably the best instance. More typical, however, is India, where substantial moves towards economic liberalisation are nevertheless seen as a gradual reorientation rather than a complete revolution in ideas. As Finance Minister V.P. Singh has put it "You must compare what we are doing not with some perfect market the textbook writers have in mind but what we had before. Then you can see the scale of our achievements and also of our problems".<sup>25</sup> Certainly it would be foolish to see unfettered capitalism as the kind of panacea state planning once seemed to be; exaggerated expectations are likely to be disappointed and lead to liberalisation policies being reversed. If this caveat is borne in mind the current movement back towards the markets in many parts of the Third World offers some modest hope of economic improvement in the decade ahead, by eliminating the worst excesses of thirty or more years of statist policies. It may begin to channel the energies and abilities of Third World citizens into growth-promoting activities. Whether it can do any more remains to be seen.

London

J.R. SHACKLETON

<sup>25</sup> Quoted in *Financial Times*, May 12, 1986.