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# Manchester Discussion Papers in Development Studies

LIBERALISATION IN THE CONTEXT OF INDUSTRIAL DEVELOPMENT IN LDCs

PAUL COOK

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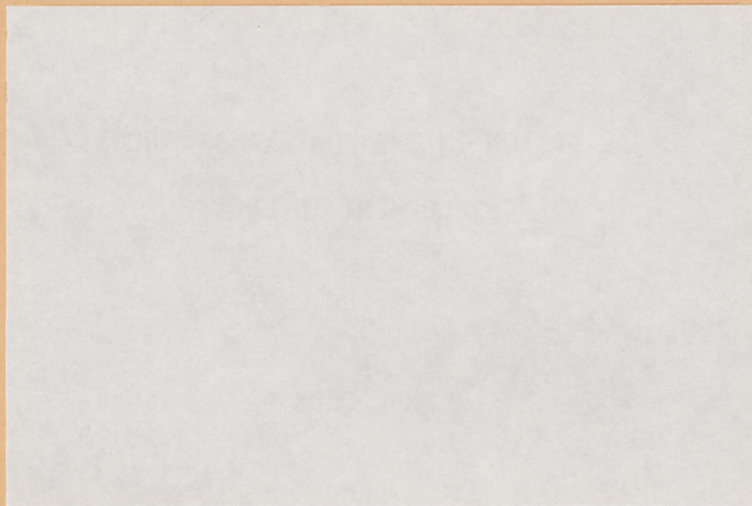

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In recent years there has been considerable pressure on less developed countries (LDCs) to adopt specific policy packages for industrial development. While in some cases the concern for change has been generated within LDC governments themselves, by far the most prominent pressure has arisen externally through industrialised country governments and international agencies. In most cases the focus of these packages has rested on some notion of economic liberalisation in the form of adopting a more market oriented approach and of reducing the direct involvement of government.

The accelerated interest in liberalisation undoubtedly arises from the perceived failures of state control and intervention, particularly in the 1960s and the 1970s. This seems to be just as much in response to poor public performance as to the problem of exaggerated expectations being attributed to the public sector and public policy (Shirley 1983, Heald 1985).

LDC governments have been actively de-emphasising the role of the state, removing distortions to the pricing system and inducing an environment which promotes the private sector in order to stimulate economic growth and diversify their economies. At the same time, at the international level, it has become normal practise to embody steps in this direction in IMF standby arrangements, World Bank structural adjustment loans, programme and project lending by major regional development banks, and in discussions between the LDCs and the private international banking sector. The extent to which this is gaining momentum can be seen in a recent report of the IMF which was able to identify a significant number of LDCs changing their public/private mix. These were considered in two groups.

First, those that experienced ideological or political turnabouts in the 1970s with a smaller role for the public sector as one of the consequences (Chile, Peru, Egypt, Jamaica, Pakistan, Sri Lanka, Tunisia, Guinea-Bissan, Uganda); and second, so called 'one step back' countries where the desirability of retrenching the public sector has been openly expressed by political leaders (Bangladesh, Somalia, Guinea, Ivory Coast, Mali, Brazil, Philippines, Argentina, Senegal, Zaire) (Berg 1982). A number can be added that have at some stage advocated a commitment to strengthen the private sector role.[1]

The issues raised by this seemingly anti-public sector ethos are many and generally extend beyond the interests of the industrial sector. This paper will not attempt a systematic survey of all the issues but will concentrate on those most relevant to industrialisation.

First, the paper briefly outlines some of the conceptual issues underlying the current wave of economic liberalisation. Second, the scope and range of measures making up liberalisation packages are reviewed in relation to the kinds of specific policy objectives that have been established in LDCs, whether economic, political or social. In the final section of the paper an attempt is made, along similar lines, to examine the factors that affect the viability of liberalisation measures and to indicate, as others have done, the concerns that ought to be taken into account in constructing policy recommendations, especially in as far as these concerns emanate from external sources.

Although the literature in this last area is in general expanding rapidly, it is still in its infancy when compared to the literature in the 1960s and 1970s that focussed on the assessment of the contribution of centralised planning and state controlled activities towards the achievement of economic, political and social goals (Shen 1972, Killick 1983).

Further, much of the current emphasis is on the assessment of liberalisation within the context of adjustment and stabilisation (Krueger 1978, Jaspersen 1981). Here the concern is not necessarily to examine the efficacy of particular liberalisation measures but more to assess overall the success or failure of the policy prescriptions of the international agencies, in particular their efficacy in controlling inflation and balance of payments equilibria (Crockett 1981, Killick 1985).

Before reviewing the theoretical reasoning behind liberalisation, and attempting to assess its implementability, it might be instructive to step back and note the context within which liberalisation is growing in fervour. Generally the debate over whether to liberalise or not is not in the context of a complete market approach versus complete centralised planning, nor in a world in which social objectives are considered unimportant, but in a world where the limitations of the two extremes, both in practice and in theory, are recognised, and where the alternative systems can meet social objectives in different ways. One is reminded of the context within which the current debate is taking place by recalling the story of the advice to be given to a benevolent dictator (Blaug 1968).

> "We would begin by telling him to distribute all resources according to prevailing concepts of equity, say, in equal amounts to everyone. We would then tell him to institute a price system, leaving all consumers and producers to maximise their own advantages. If there were any industries operating under increasing

returns to scale, we would instruct him to finance their deficits. Whenever externalities appeared in production or consumption, we would urge to let the parties involved find their own bargaining solution, while providing them with information about the costs and benefits of the externalities. We would admonish him to hold frequent referenda on the provision of public goods and we would never tire of reminding him that these together with all his other expenditures, could only be financed by means of head taxes and non-recurring capital levies. If he pointed out that a non-recurring capital levy could not supply a steady source of revenue, while head taxes would fall with equal force on the old and the young, the clever and the stupid, in conflict with the prevailing norms of equity, we would have to emphasise that any other method of raising taxes would create second-best problems.

With the advent of second-best problems, we could advise him no further, except of course, to hire a great many economists to carry out cost-benefit analysis of each and every policy proposed that could be put to him. But he might say, what about the Wealth of Nations and the workings of the invisible hand? It still holds, we might answer, but with a difference: if it did not, we would have told you to abdicate in favour of a central planning bureau."

Despite the objections to the market system and the incompatibility between the pure welfare approach and the perfect market system, and despite the fact that the existence of government guarantees we are in a second-best world, the real world debate about liberalisation in most mixed economies of the LDCs is concerned with degrees of change from an imperfect situation to a better one, while recognising that the term 'better' is itself not value free.

## CONCEPTUAL BASIS FOR LIBERALISATION POLICY IN LDCs

Economic liberalisation signifies the movement towards a more market oriented economy. Interpreted in this manner it is evident that not all the measures under the guise of liberalisation conform to this conception.

Although not strictly accurate, the arguments for liberalisation rest on a comparison of the benefits and losses arising from the two polar extremes for market orientation. At one end of the spectrum is the intensely competitive situation envisaged by Adam Smith where self-interest regulated by competition is the driving-force to guide society into whatever direction it is willing to pay for. The regulator is competition, providing social benefits from the conflicting self-interest of members of society. Embodied in Adam Smith's formulation are the deep-seated laws of evolution which propel the market system, in its perfect form, in an ascending spiral of productivity (Hellbroner 1972). In this world, market prices equal

their respective shadow prices and private costs reflect social costs.

At the other end, markets for factors and products are imperfect. In the extreme form markets are underdeveloped, possibly in a pre-capitalistic sense. If they are developed, then they are distorted as a result either of intervention in the market or of an externality, both of which have tended to cause a divergence between the social and private costs.

The primary task of liberalisation in this context, although concerned with promoting the merits of the market place, is with the efficacy of producing efficient markets, the essence of which is to reduce the cost of making transactions in those markets (Lal 1985).

Transactions costs are present in any market and include the costs of excluding non-buyers as well as those acquiring and transmitting the relevant information about demand and supply of a particular product to market participants. They drive a wedge between the buyer's and the seller's price; the larger the wedge the more imperfect is the market. Zero transactions costs signify perfect markets. To restate this, the wedge measures the deviation between the market price (actual price) and its shadow price. As a result of this potential deviation, policy makers are presented with a conflict between the welfare and efficiency implications.

This can easily be seen by referring to the specific ways in which the LDC governments have rationalised market intervention. On the buyer's side there are numerous examples of efforts to implement a wide range of welfare related measures, for example in the form of direct attacks on the problems of health and education or in the industrial sector by adopting pricing policies that favour consumers. This latter policy was applied in Sri Lanka between 1970 and 1977 where state operated enterprises provided goods at low prices to consumers (Stern 1984, Cook 1985).

The combined effect of all welfarist oriented policies in Sri Lanka during this time resulted in a high 'physical quality of life' index for a country with a relatively low level of per capita income (Herring 1984). In these years Sri Lanka placed a higher priority on direct and indirect consumer subsidisation than on market efficiency.

On the seller's side governments throughout the 1960s and 1970s encouraged industrialisation by adopting and maintaining economic systems designed to foster import substitution. The range of measures included the maintenance of overvalued exchange rates, high import tariffs on luxury consumer items and quantitative controls and restrictions on imports. In Nigeria, for example, intervention for import substitution was rationalised on the basis of the timescale it would have taken the market mechanism to accomplish the transition from a dependent agricultural economy to an industrialising one (Smith 1976).

Intervention has also been justified from both the buyer's and seller's point of view when its primary intention is to reduce the transactions costs in markets that are poorly developed. Here facilitating exchange by providing essential infrastructure and improved communications, for example, providing landing sites and improving feeder roads to facilitate exchange between producers and consumers.

It is within this context that the advocates of the present wave of liberalisation measures in LDCs find the fuel for their arguments. The 'welfarist' policies pursued by many governments are criticised for their bias against the supply side, creating disincentive effects for producers, particularly where price controls are in effect. Even where governments have maintained producer prices while providing consumes with low prices, the costs of subsidisation have not escaped scrutiny by those who argue that other measures are more effective in redistributing income.

But by far the most foreceful attack on market intervention has come from those using inefficiency arguments. They argue that inappropriate forms of intervention to encourage import substituting industrialisation have resulted in distorted prices in both factor and product markets. This has occurred as a result of the effects on market entry, the protection of monopolies and the creation of excess profitability. Domestic prices often exceed world prices under trade restrictions. Bias has also been established against exports by the excess profits in import substitution as a result of the exchange rates and protective measures that have been adopted (Balassa 1975).

There is no necessary antithesis between liberalisation and import substitution, however, since these arguments could be applied to those governments who in the process of switching from an 'inward looking' industrialisation policy to a more 'outward looking' approach, have introduced more distortions. The 'outward looking' industrialisation has often been fostered by forming a complex network of incentive schemes designed to promote exports. However, only in cases where the incentive effects have offset the bias against exports could it be claimed that no new distorting effects are introduced. In practice the effect of export bias may be to divert resources from satisfying the local market. We shall return to this point in the next section. Those advocating liberalisation, however, give little attention directly to the externality case. A minimisation of the importance of externalities has come from several perspectives. Critics have argued that the market mechanism can achieve a Pareto optimum despite externalities in both production and consumption since it is possible to devise a private bargaining solution to eliminate externalities. This assumes that the suffering group can act together and agree to form a pressure group. The disregard for the importance of externalities as a source of divergence between private and social cost in the current wave of liberalisation has also been echoed in some of the earlier planning literature (Little & Mirrlees 1974).

Little and Mirrlees to a large extent dismissed the importance of externalities so that in the derivation of so-called 'efficiency prices' the wedge to be eliminated was represented by the distorting effects of government intervention (Stewart 1978). The subsequent use of 'social prices' in planning which embodied interpersonal and intertemporal criteria, was developed not so much on the basis of a recognition that externalities were important, as on the premise that fiscal policies alone were inadequate instruments for redistributional objectives (Squires and Van der Tak 1975).

To conclude this section, although distortions on both the buyer's and seller's side have featured prominently in the arguments for liberalisation, the concentration of interest appears primarily to rest on inefficiency arguments, pointing in particular to the price-distorting effects of direct and indirect public sector intervention. The fact that welfarist or social arguments are not at the forefront suggests there is a presumption that these can be handled more effectively by general fiscal measures. As regards non-government distorting effects of prices (i.e., externalities) there is a presumption that the policy-induced distortions are more 'serious' than the supposed distortion of the market that they were designed to cure i.e., the imperfect bureaucrats of the real world.[2]

Even to the market advocates, intervention by government can appear to be rational when it is used to correct for inadequacies of the market mechanism, justified on the basis that Pareto optimum conditions are reputedly valid only for a given distribution of income which may not be the ideal distribution. This type of rationalisation prevalent in the 1970s, is now considered invalid for the bias it creates against the producer side. On the other hand, intervention by dictating market conditions through either price or non-price intervention, possibly by providing producer incentives, may be warranted. This is clearly evident in some recent types of liberalisation package. It seems this is tenable if the market that exists has failed to develop the degree of competition that would ensure that the system was inherently bias free; that is, intervention, as in the bargaining process argued to correct for externalities, is the compensating element.

## MARKET ORIENTED POLICIES FOR INDUSTRIAL DEVELOPMENT

The extent to which liberalisation has been pursued in recent years has varied from country to country, although, just like the spread of the green revolution technology, it has in some form or another been adopted by most LDC governments.[3] The type of reforms have also been wide ranging in every respect including changes in the basis of productive activities; in institutional and administrative structures and in the dismantling of policy networks. Included in this range have been attempts to increase the degree of competition faced by domestic producers by reducing trade

barriers; removing credit constraints in order to facilitate the ease of entry for newly established businesses; denationalising state-owned financial institutions so that there will be a greater tendency for competitive forces to establish relative interest rates; and attempts to remove distortions in tax systems that provide unequal advantages to different sectors.

It is easy to see from the breadth of measures described above, that they fall within the province of a broad set of economic policies, ranging from macroeconomic stabilisation instruments with their concern for aggregate variables such as the rate of inflation and the balance of payments position, to instruments with a more sectoral interest such as foreign trade, industry and agriculture.

Although it is likely, to a differing degree, that all policies either directly or indirectly, will have an impact on industrial development, this section will concentrate on those which appear to be more significant. These can be grouped as macroeconomic, trade-related, and industrial policies. More specifically, the focus will be on the types of policy changes which have increased market orientation or have reduced the direct involvement of the state.

Many of the recent policy reforms in LDCs have originated from some form of external influence. Inevitably the degree of influence has varied according to the form of 'dialogue' established between the LDC government and the external party. These have ranged from research exchange, to policy conditions being formally stipulated in multilateral or bilateral lending arrangements. Clearly the latter, with the increasing indebtedness in LDCs, particularly after 1973, has grown in relative importance and much of the literature has been preoccupied with assessing the impacts of these externally-induced policy reforms on LDC economies. Most prominent among these have been the measures embodied in IMF lending arrangements and the wider ranging structural adjustment loans (SALs) of the World Bank. These are of interest because the conditionality associated with these loans have incorporated liberalising elements and, although the aims of the policies have primarily been macro-oriented, particularly the demand management oriented IMF programmes, many of the measures have sector specific consequences.

An analysis of the objectives of 30 IMF programmes supported by upper tranche credits in 1964-79 showed that a strengthening of the balance of payments situation was the primary aim, inflation and growth being secondary. Income distribution featured hardly at all among the stated aims. In terms of instruments, exchange rate adjustments and control of credit creation, formed up to half the IMF programmes although for each country there was no completely stereo-typed package, these being derived as a result of IMF assessment of the conditionality suitable to the country's conditions, the regard for uniformity in treatmnt across countries, and an assessment of probable reception (Killick 1985).

World Bank structural adjustment loans have not been as narrowly based on demand management but have focussed attention more broadly, including a consideration of supply side elements. Since their instigation in 1980, 32 SALs have been made in 16 countries (Mosley 1985). Most have been confined to the faster growing outward looking economies. Like the IMF there is no standard package which is imposed on any recipient country although most have a unifyied approach, as we shall see, embodying market and trade oriented measures.

Besides the IMF credits, and SALs with their broader focus, there is considerable specific 'dialogue' occuring through both sector and project based lending arrangements, although it might be reasonable to assume that there is a positive correlation between the size of the credit arangement and the extent of conditionality. It is quite common for both of these types of loans, whether from the World Bank and various regional development banks, for example, the Asian Development Bank (ADB), to embody conditions or at least to involve exchange in policy views prior to lending in the form of bank missions and policy surveys. In the case of industrial sector loans, most of these are effected through the establishment of lines of credit with public sector development finance institutions (DFIs). These are used to channel resources to comparatively small projects, mostly in the private sector. There has been a growing tendency in recent years to direct funds towards the private sector rather than to public sector industrial programmes. This has meant increasing lines of credit with DFIs whose on-lending arrangements had traditionally been with the private sector, and through policy dialogue reorienting on-lending of previously state sector focussed DFI towards the private sector. An indication of their importance as 'windows' for foreign exchange borrowing can be seen through the lending activities of the ADB. About 13 percent of total ADB lending and four-fifths of total ADB lending to the industrial sector have been channelled through DFIs (ADB).

Important aspects in the lending programmes of the World Bank and to some extent in regional bank programmes are production, investment, capacity utilisation and supporting monetary and fiscal policies.

Although policy changes relevant to industrial sector development are filtered along several lines of dialogue, each vehicle is likely to incorporate elements of the different types of policies. IMF, SALs and sector specific loans often embody macro and trade related policies, and although the IMF lending and SALs have a broader focus, many embody some sector specific measures (Killick 1985). The policy measures in IMF programmes usually involve exchange rate adjustment and monetary control while the SALs incorporate a larger range of measures. Even where sector measures are involved, however, they are not generally in any SAL programme confined to a single sector. For example, the first SAL to Thailand in 1982 covered measures

to deregulate livestock, and reduce taxation and regulation in rubber, rice, maize, sugar and cassava; the first SAL to South Korea in 1981 included stipulations for price rises in consumer energy prices, the elimination of fertiliser subsidies and the postponement of plans to expand automobile capacity.

A recent study of 13 countries with SALs showed that ordering of public investment priorities was requested in 80 percent of cases, and reforms of agricultural policy and in the system of export incentives featured prominently (Mosley 1985). On the other hand, sector specific programmes for industrial development, besides investment prioritising, (particularly towards directing investment to competitive industries) and industrial policy formulation, incorporated macro and trade-related measures.

Important in this context is not only the content of the policy packages but the emphasis on the compliance associated with these measures. It was stated earlier that the content of many of the programmes was not uniform although a number of common features could be identified. The World Bank states that the content of the policy reform package negotiated with each borrower is determined purely by the Bank's assessment of the quality of that borrower's economic policies and not at all by its bargaining strength (Landrell-Mills 1981). Uniformity in approach, however, with regard to SALs is probably derived by use of a 'price distortion index' published in the 1983 World Development Report which summarises the effects of state intervention across a number of markets.[4]

Although not explicitly stated, the criteria established for these types of programmes, covering the complete spectrum of trade and macro-economic policy, particularly institutional reform, will establish to a large extent the context within which sectoral and project specific lending will take place. Indeed the dialogue between the major lending institutions themselves will lead to some degree of uniformity in the policy packages put forward in their lending schemes.[5] The development banks themselves will often undertake an in-country policy review as a prior step to negotiating lending arrangements.

So far we have defined liberalisation to include the removal of price distortions and the reduction in state activity, many of which have been embodied in macro-economic, trade-related and industrial policies. This can be extended to include the steps taken to develop the market system. Within (a), removing market distortion, we can include the distortions in the product, labour and capital markets. In (b), changing the public and private mix are included forms of privatisation and reductions in government expenditure and its sphere of influence. In this category can also be considered those measures which have been introduced by government to offset the bias in existing policy or those that provide positive incentives to the industrial sector. Finally in (c), market development, we shall consider schemes

that improve the efficiency and functioning of the market mechanism.

Some of the measures that have been introduced in a wide range of countries embodied in macroeconomic, trade-related and industrial policies are summarised in the table below.

TABLE 1 : STEPS TAKEN TOWARDS LIBERALISATION

| Type of policy change / Policy area | Removal of market distortion | Changing public/ private mix | Market Development |
|---|---|---|---|
| Macroeconomic policy | Rate of interest policy<br>Allocation of credit control of money supply | Reduced government expenditure e.g. on industrial sector projects | Strengthening role of financial institutions e.g. rural banking, private sector focus for DFI lending |
| Trade-related policy | Retionalisation of tariff structure, tariff reduction, removing import controls<br>Exchange rate adjustment | Increased intervention, e.g. incentive schemes for exports, refinance schemes | Creating and strengthening institutions e.g. Export Development Boards<br>Export processing zones |
| Industrial policy | Reforming tax system<br>Competition policy, deregulation and monopoly control<br>Reform SOE pricing policy<br>Rationalising industrial licensing<br>Labour market policy | Privatisation including user charges and denationalisation<br>Reform of SOE operating objectives and performance criteria<br>Increased intervention e.g. tax holidays for new entrants in private sector | Creating institutions for the private sector sector market<br>Information e.g. Business Development Centres<br>Creating Infrastructure e.g. feeder road construction, fish landing and marketing sites<br>Legal framework for competition policy |

With such a wide variety of measures, it would be futile, in the context of this paper, to attempt a systematic review of each. Instead in the remainder of this section only

the more prominent elements in each category will be discussed by reference to the arguments for policy reform in relation to a number of specific instruments and to some of the conflicts that potentially exist between policy instruments and objectives.

Removal of market distortion

Although in this section various distortions are treated separately there is a need to bear in mind the actual interdependence that can exist between the distortions themselves which cover the capital, product and labour markets (Balassa 1975).

During the 1950s and 1960s import substituting industrialisation (ISI) featured prominently in large economies including Brazil, Argentina, India, Pakistan, the Philippines and Mexico. Other countries joined them in the mid-1960s, including Nigeria, Ghana, Zambia and Kenya. These economies all pursued ISI by adopting a range of inward-looking policies. The type of industrialisation that followed varied from the easy stage of substitution in consumer goods to more complex forms in terms of producing intermediate and capital goods. Many countries do not progress far beyond the first stage (Kirkpatrick and Nixson 1983, Schmitz 1984).

Inevitably the need to protect growing domestic industries and to create investment were important strands of this type of development strategy. The support for ISI largely rested on the belief that exports offered few possibilities for economic growth. This was rationalised on the basis of the competitive strength of the industrialised countries, the protection of the industrialised countries, and the proposition that the world demand for primary products, as exports, were assured of a slow growth.

The elaborate network of protective measures that was built up included import quotas and licensing schemes, differential tariffs, and quotas for luxury consumer and capital items, effectively reducing the price of capital. Over-valued exchange rates were used to create a relative price effect favouring imports rather than domestic goods to make cheap imported inputs available for domestic production (Galenson 1984).

The effects of protection have been extensively explored in the literature, and include inefficient production due to high domestic prices, inefficieny in the use of resources behind tariff walls and X - inefficiency as monopolies are often established. Besides demand constraints there have been considerable supply side constraints created by the bias of ISI. Effective protection estimates show a concentration of export manufacturing activities in groups of low protection levels while import substituting industries dominate highly protective groups.

Although initially the policies were applied for protective reasons the subsequent additions and revisions have been

piece-meal for a variety of motives, including balance of payments, and in response to the pressure from interest groups. In much of the protective framework little attention was given to the implications of protecting raw materials and intermediate goods for industries producing finished manufactures, or to the interaction between the various protective devices (i.e., tariffs) and the exchange rate.

*Trade restrictions and exchange rates*

On balance, the measures described above have prevented the growth of competition for domestic industries both in terms of competition from home industries and through trade. It is therefore argued that the resulting structure of industrial production is incompatible with comparative advantage. This is argued because the tariffs and export subsidies establish a difference directly between the domestic price and the foreign price as an additional charge on imported goods. Quotas and other quantitative restrictions, on the other hand, act indirectly on domestic prices, causing them to rise by restricting supply. As measures themselves, quanitative restrictions act quickly and assure the protection of domestic industries against dumping and unfair practices. Measurement of the significance of the quantitative restrictions in terms of overall protection present methodological difficulties which have led analysts to advocate the elimination of these measures rather than incorporate them in a scheme of rationalisation. With regard to tariffs, decisions to use imports are made after accounting for price and quality differences while domestic producers can raise prices to the extent of the tariffs. This reflects the degree of protection which, subject to caution over the data used, can easily be measured. Tariffs, unlike quantitative controls, were also justified because of their contribution to government revenue (e.g., in Sri Lanka taxes on imports accounted for 25 percent of total tax revenue in 1983).

In terms of reform, the maxim for liberalisation rests on the market principle. At the extreme this is represented by the abolition of all forms of protection. In terms of the real world, with regard to practicality and revenue, this amounts to granting equal protection to all industries and letting competition do the rest. This is accomplished by establishing low uniform rates of effective protection, as was attempted in a number of countries in the late 1970s, including Chile and Sri Lanka. At the theoretical level, equalising effective protection rates is dependent upon the elimination of factor market imperfections so that the market price of factors equal their respective shadow rates.

On this basis the effective protection criteria i.e., providing all industries within a sector with equal effective protection (not equal nominal protection), is justified because on the one hand it provides a measure of the domestic resource cost of earning (or saving) foreign exchange in particular activities; and on the other hand, if it is assumed that there are no differences among manufacturing

activities in relation to external economies they generate, the growth contribution of the manufacturing sector is maximised and the domestic resource cost of earning foreign exchange is minimised (Bertrand 1972, Balassa 1975).

Even within this framework, the protectionist 'lobby' always argued the case for special treatment of technologically sophisticated industries receiving additional protection because they promise greater than average productivity improvements, although it may be preferable in this case directly to subsidise product research and development to avoid the establishment of high cost businesses (Balassa 1975).

In practice, equalising effective protection rates in the manufacturing sector would normally require the raising of nominal rates from lower to higher stages of transformation although this ought to occur at relatively low overall rates of effective protection. The exception results from instances where external economies differ from the average or where special pleading occurs for a so-called infant industry. This will, therefore, inevitably entail raising some rates and lowering others. In practice implementation may be quite difficult; for example, in Sri Lanka the attempt to rationalise the tariff structure since 1977 has involved more than 350 changes in tariff levels.

The exchange rate itself has been considered an important variable for industrial development. An over-valued exchange rate, along with exchange controls, was justified under ISI on the basis that it provided relatively cheap imported inputs into domestic industry, and that it helped to prevent exports from diverting domestic resources from agriculture to industrial activities. But the attempt in recent years to shift economies from an inward to an outward looking stance, while incorporated in both the stabilisation and developmental points of view, has raised a number of contradictory issues.

On the stabilisaton front a movement of the exchange rate towards an equilibrium (market) rate has been in part intended to moderate inflationary tendencies and strengthen the balance of payments, largely at the instigation of the IMF. To restate the argument there has been a move towards the "restoration of macroeconomic balance" (Krueger 1985). The concern in this context in relation to attempts to liberalise i.e., moving towards an equilibrium exchange rate, has been with the degree of capital mobility and the extent of exchange controls in place.

From the developmental point of view, revision of the exchange rate has been related to the structure of the protective framework. Overvalued exchange rates were defended because the imposition of protective measures generally permitted an equilibrium in the balance of trade to be reached at a lower exchange rate under free trade, since the appreciation of the exchange rate was required to

compensate for the fall in imports brought about by protection (Balassa 1982). Conversely, eliminating protection measures would necessitate a devaluation in order to offset the resulting deficit in the balance of trade i.e., a compensated devaluation. Here it is envisaged that simultaneous changes in tariff and exchange rates will take place, initially producing a compensated devaluation with export taxes, together with changes in the tariff and subsidy structure that are phased over a longer period. Both Pakistan and Sri Lanka have recently undertaken these types of reform. The monetary approach to the balance of payments in this instance is, therefore, not valid, as no change occurs in a country's foreign exchange reserves, nor, therefore in the domestic money supply. There is also no change in the price level and correspondingly no change in the real value of money holdings. The real problem revolves around estimating the hypothetical free trade exchange rate. (The information needed here concerns supply and demand responses to changes in tariffs, export subsidies and exchange rates).

For stabilisation, the concern has been with the difficulty presented by the financially repressed economy where credit rationing and poor financial markets are evident (McKinnon 1973 and Shaw 1973). In this context the adjustment in the exchange rate (devaluation) needs to be accompanied by changes in monetary policy, i.e., increases in the nominal rate of interest. This has further caused concern for the interrelation between the capital account and the current account of the balance of payments. Devaluation in this way, with a restricted import structure, could lead to sizeable capital inflows which permit an increase in imports and could actually increase the current account deficit on the balance of payments.

The issue, therefore, of an optimal mix of exchange rate changes and increased import flows as a means of eliminating the difference between domestic and world prices of exportables and import-competing goods, has not yet been resolved (Krueger 1982).

*Interest rates*

The importance of money in the development process has been increasingly recognised. Again in this context the issues of stabilisation versus development loom large. Earlier policy and practice led central banks in LDCs to set lower discount rates for investment. Often commercial banks were state controlled or operated under highly institutionalised forms of control (where bank charges deviated from the marginal cost of funds). Such an institutional structure, although attractive to borrowers and financing of government debt, with low rates of interest, (sometimes negative in real terms in the face of inflation), made lending less attractive from the banks point of view, and resulted in excess demand for loanable funds and credit rationalisation. Such a policy discourages the demand for financial assets and leads to financial disintermediation as the banking system cannot fulfill its function of channelling funds

to investment and production. In this situation there is a bias towards present consumption at the expense of savings.

Earlier this situation favoured import substituting activities as these represented areas with lower risk, since they had no competition. Credit rationing tended to promote capital intensive activities. There was also a tendency for such schemes to pre-empt opportunities for small businesses, driving them to borrow in higher interest rate 'curb' markets.

The arguments for financial reform stress the importance of higher real interest rates in encouraging the build up of real money balances, increased financial intermediation and the unification of financial markets. However, raising real interest rates without regard to the rates of return on investment may run counter to development aims. It may not necessarily be true that once funds are generated through the accumulation of real balances investment will take care of itself (Roe 1982).

In LDCs however, the capacity of the domestic financial system to offer high real rates of interest on deposits will itself depend on the opportunities available to utilise those funds at an equally high real loan rate. However, the loan rate itself is determined by the existence of bankable projects yielding a sufficiently high return. There are many reasons why this may not be apparent (including poor social overhead capital). Funds may then be diverted to higher yielding investments in the rest of the world (McKinnon 1973, Shaw 1973).

Further, the nature of the imperfections in financial markets must be considered in determining the 'appropriate' level of interest rates. Lending operations in LDCs have a variety of risks not evident in perfect markets where full information about borrowers exists. In LDCs, lending rates include the cost of mediating a loan plus a premium for risk. As a result, the spread between the rate paid to owners of wealth on their savings (the deposit rate) and the loan rate (required of borrowers) is often wider in LDCs than in industrialised countries (Roe 1982). Unless all imperfections are removed, the financial system will not be in a position to offer real interest rates on deposits which approach the rate of return to capital.

There is, therefore, a transitional cost attached to policy packages that attempt through monetary policy to establish interest rates that approach shadow interest rates (e.g., of the type calculated by Little/Mirrlees 1969) when overall imperfections in the financial system are not dealt with. An assessment of one type of liberalisation, that might result from McKinnon-type findings, must focus on the costs of liberalisation itself as well as on the costs of financial retardisation (Khatkhate 1982). It is apparent that concern has centred upon the functioning of the financial sector rather than with development in terms of real growth.

*Labour markets*

Minimum wage legislation may increase the cost of labour above the market rate. Much of the increase in wages in Pakistan in the 1970s appears to be due to non-market factors (Guisinger 1981). Distortions raise the cost of labour, particularly unskilled labour. Higher labour costs combined with indirect subsidisation of capital have led to misallocation of resources, encouraging a shift from labour intensive activities to capital intensive activities. Again, in LDCs, where the minimum wage is not subject to tax but where the marginal tax is high on incomes above the minimum level, there will be a tendency to discourage the movement of labour from lower to higher productivity activities. (Balassa 1982). Policy reforms in this area have entailed the elimination of minimum wages and the rationalisation of levels of income tax.

Changing public/private mix

State Operated Enterprises (SOEs) in the manufacturing sector were established for a wide range of reasons. Some were economic (high risk ventures important, for example, in South Korea; economies of scale; and linkage effects, compensating for market imperfections). Some were social (the satisfaction of distributional objectives through subsidisation to consumers; employment). Some were political (changes in the ideological perspectives of government, for example, as in Sri Lanka and Pakistan).

Assessment of SOE performance has equally taken on a wide ranging set of criteria, and debate continues on the outcomes, whether from the economic, social or political perspectives. Many commentators point to the inconsistency between these objectives, arguing that social objectives can be fulfilled by other means. Clearly judgement in economic (or more stringently financial) terms points to low profitability, poor efficiency and underutilised capacity in a large proportion of SOEs in LDCs.

Proposed reforms of SOEs have taken several forms but most prominently feature attempts to raise the level of competition they face, and to reduce the budgetary support for their operation; the extreme form involves selling them off to the private sector. In the former case, this has often meant reducing the bureaucratic links between central government and an SOE; reducing budgetary support by forcing SOEs to borrow in commercial money markets; and removing import controls that protected state activities. These in some form or other have been attempted recently in Zaire, Zambia, and Sri Lanka (Steel and Evans 1984, Cook 1985).

In the latter case, privatisation has been attracting interest. A recent USAID survey soliciting the views of 65 LDCs reported that 61 LDCs responded that they were interested in the policy option of privatisation as a means for improving SOE performance.[6]

Market Development

Although the state in LDCs has always played an important role in market development, reducing transactions costs through its commitment to develop communication and infrastructure (Jussawalla & Lamberton 1982), attention here will concentrate on facets of market development that have more obviously been incorporated in market oriented approaches. In particular three elements are of current interest.

First, there can be no denying that in virtually all LDCs the role the state plays has a very strong influence on indigenous entrepreneurial activity both in terms of the economic and constitutional environment within which private enterprises operate. The economic factors, such as access to finance, and protection, were discussed earlier. Current interest also centres on the latter in the efforts being made to ensure that confidence for private sector development is maintained through appropriate legislation (repealing legislation that permits nationalisation); investment codes (relaxing restrictions on market entry (Collins 1985); and the review of monopoly policy.

Second, growing concern has been expressed over the escalation of government expenditures, particularly those attributable to the failure to recognise the recurrent cost implication of past capital expenditure (Heller, 1974). Much of this related to the provision of social services, health and education, and subsidies to state operated enterprises. Subsequently efforts have been made not only to scale down total expenditure but to switch to more market development oriented expenditure designed to improve basic infrastructure. Efforts have also been made to promote the capacity of the private sector through institutional strengthening (e.g., the USAID assisted Business Development Centre in Sri Lanka).

Finally, there have been numerous attempts in recent times to erode some of the more deep seated obstacles to the creation of market oriented economies, by establishing export processing zones. Despite their limitations in terms of poor linkages to the home market and low levels of technological transfer created by the externally oriented ownership patterns and the relatively standardised types of industries that have typically been attracted, these zones have represented a means to create a more market oriented environment by circumventing the networks of dysfunctional bureaucratic controls that the state has typically established.

## ASSESSMENT OF LIBERALISATION

It will be obvious to any policy-maker that the attempt to evaluate the effects of liberalisation policies raises complex issues. A variety of factors need to be considered, many of which were probably given consideration in the original policy formulations. The post factor evaluation of

liberalisation policies is still in its infancy (Krueger 1978). The studies that do exist have principally been concerned with examining the impact and consequences of stabilisation programmes (Donovan 1982), mainly in terms of their effects on macroeconomic variables such as the rate of inflation and the balance of payments, but increasingly on the social and distributional ramifications (Foxley 1981, Addison and Demery 1985). Few have specifically addressed themselves to the liberalisating components of these programmes. Fewer still have either examined the effects of stabilisation programmes, or the market oriented elements of these, together with industrial policies, on the industrial sector.

It is evident that at least two questions need to be addressed. The first concerns the contribution the set of liberalisation measures have made to industrial development. The second, not unrelated to the first, asks to what extent liberalisation, and indeed specific elements of the liberalisation package, have effectively been implemented. In this final section a framework will be developed within which these questions can be examined.

In order to tackle the first question, it is crucial to identify the precise nature of the contribution. We begin by reviewing a number of criteria established for industrial development. These cover economic, social and political goals. Within this framework there have been a variety of attempts from those interested in public policy to assess the consequences of the reforms in relation to policy expectations through studies at both the macro and micro level. At the macro level this has been done by monitoring the overall improvements accruing to the economy and sector wide indicators, and at the micro level by examining the effects of liberalisation programmes on individuals and groups in society, whether it be small rural farmers, urban poor or industrial enterprise operations.

With regard to the second question, which is primarily concerned with how successfully the reforms were implemented, a number of factors are considered. These are categorised into groups of factors whose effects can be designated as economic, political, social and administrative. A summary is given in Table 3.

Contribution to industrial development

A number of underlying factors affect the measurement of the success or failure of the reforms. The first point to consider is the timeframe for performance assessment. Both policy application and policy effects maybe stretched over considerable periods of time with varying degrees of severity. For example, the removal of distortions in the tariff structure is likely to be accomplished in a phased programme which attempts to equalise rates of effective protection lasting five years or more. Equally the adjustment to these changes in terms of the response of domestic producers and importers could be relatively slow, according to the extent to which forms of uncertainty were created in the pre-reform period.

Second, many of the distortions and the policy instruments forming parts of the reform package may be interconnected. In the former case there are complementarities between many of the distortions in the product, labour and capital markets (Balassa 1982) while, as was shown earlier, the relatively successful application of some parts of the reform package is dependent upon other parts. For instance, it is unlikely that the effects of liberalising the tariff structure will be beneficial unless accompanied by a devaluation of the exchange rate. Further, it might be felt that the direction of bias established in the pre-reform system can be offset by compensating measures that attempt to compensate in the opposite direction, while this consideration departs from the purist view of achieving 'market neutrality', it may be defended on grounds relating to political expediency and time-phasing. The introduction of many of the incentive and preference schemes for exporters can be viewed in this light, swinging the pendulum from bias towards import substitution, not to a neutral position facing importers and exports, but to a positive bias favouring exporters. In terms of success, then, much will depend on whether the compensating policy measure actually offsets or over-compensates the existing arrangements. In either case, the outcome may still be positive, leading, for example to a stimulus in manufacturing exports although in terms of judging liberalisation, over-compensation perpetuates the misallocation of resources, as in the pre-reform case (except this time in a different direction).

Finally, there is the question of how pre-liberalisation and post-liberalisation evaluation differs. Two problems are presented here. The first concerns the difficulty of selecting compatible indicators with which to measure the performance of both the pre and post-reform state of affairs. For example, in the distorted pre-reform situation, employment (used as an indicator) may have been high because a premium was deliberately placed on raising employment levels; yet in the post-reform period, the argument for efficient allocation of resources, while claiming to have positive employment effects (Balassa 1975), does not purport to exceed those in the previous situation if those levels were artificailly above the equilibrium state. Second, there is the difficulty of selecting the indicator itself, which may not be a single yardstick but may require the development of some form of weighted index incorporating a wide range of variables. An example may be helpful.

Following the arguments for the market oriented approach it might be expected that conventional variables like profitability, output and employment are relevant indicators of performance, since the removal of distortions make the divergency between social and private costs irrelevant. The little analysis which has taken place casts some doubt in this sphere with regard to employment and profitability (Kirkpatrick 1985, Kirkpatrick, Lee and Nixson 1984), but these are not necessarily arguments confined to comparative statics. Similar arguments have been adopted in defence

of many of the IMF programmes. There it has been claimed that it is not always possible to show positive improvements resulting from their programmes because it is difficult statistically to compare the dynamic changes taking place in the pre- and post-states. The fact that the post-state outcome may show a worsened situation does not mean the programme has failed if the continuance of the pre-reform situation would have brought about an even worse outcome.

Against this backdrop, the three aspects of liberalisation (the removal of distortions, changing the public/private mix, and market development) can be assessed in relation to the policy objectives and outcomes most prominently advocated. Defining these objectives in relation to industrial development is itself a complex matter, since in reality it is unlikely that they can be reduced to a single form. Most policies embody sets of multiple objectives although it is unlikely that all have equal weighting (Loucks 1975, Killick 1981). It is also conceivable that the problems that apply to the selection of indicators apply equally to the setting of objectives. Objectives change both in the pre-reform stage and during the reform period in response to a host of factors, some of which may be related to changes in internal political and social preferences, and some of which are in response to external shocks.

TABLE 2 : OBJECTIVES OF LIBERALISATION MEASURES

| Types of reforms / Policy expectations | Removal of distortions | Public/private mix | Market Development |
|---|---|---|---|
| Economic | Improved financial profitability<br>Rational allocation between factors of production<br>Increase in output of tradeable goods | Improved efficiency<br>Reduced government expenditure<br>Reduced budgetary support for SOE<br>Improved budget deficit<br>Reduced consumer subsidisation | Improvement to market structures<br>Increased competition<br>Improved delivery systems<br>Lower prices to consumers |
| Social | Improved income distribution | Reduced tax burden<br>More efficient use of tax revenue | Increased choice of goods and services<br>Improved standards |

Difficulties are presented in assessing the contribution of liberalisation measures for industrial development when account is taken of the multiple objectives, that exist, not only between different types of policies (i.e., stabilisation, trade, industrial) but also between different policy instruments (i.e., rate of interest reform, exchange rate reform). Since it is likely that some of these objectives may conflict, the task of isolating the contribution to industrial development made by specific instruments becomes difficult.

With these difficulties in mind, some of the more prominent objectives are summarised in Table 2. Even within this wide range of objectives it is clear that some are inter-related. There is also the problem of separability in relation to the objectives themselves. To what extent is employment an objective in its own right as opposed to a means by which the income distribution objective is achieved? In this table political objectives are assumed to be comparable with economic and social objectives. This is a point to which we return in the last section.

A number of studies at the macro level exist that have examined industrial development in relation to each of these objectives. These have generally devoted attention to the policy outcome rather than the efficiency of implementation (Corbo and Melo 1985). Similarly, although the more recent of them have concentrated on the effects of change from an import substituting strategy to an export oriented type of industrialisation, none has specifically focussed on the effects of the market oriented elements. In these cases an extensive range of variables has been analysed including changes in output and its composition (Chenery and Syrquin 1975), export share (Balassa 1984), export composition (Kirkpatrick, Lee and Nixson 1984), improved capacity utilisation (Bastista et al 1981), productivity and concentration levels in manufacturing (Kirkpatrick, Lee and Nixson 1984). While some of those studies, for instance a recent World Bank study examining changes in intermediate input use in nine countries (Kubo 1985), have looked at structural change resulting from the application of different, and often contrasting economic policies, they have not necessarily isolated the effects attributable to specific measures. A similar trend has been evident in attempts to examine the impact of specific policy instruments, although in this sphere most have concentrated on the effects of the pre-reform state (e.g., the effects of tariff protection)(Kemal 1978).

At the micro level there are signs that work is under way. A number of recent studies have concentrated on the financial and economic objectives of stabilisation policies in Latin America by examining their impact on firm and industry level operations (Petrei and Tybout 1984, Corbo and Melo 1985). There are also studies monitoring the progress of particular state operated enterprises in terms of output, productivity and employment, in response to policy changes, e.g., the monitoring programmes instituted recently in Pakistan (Jones

1982, Killick 1983).

A number of studies also exist that have attempted to measure the distortive or biased effect of individual policy instruments and economic variables, or of particular systems (i.e., protection). Among these can be included those on price distortion (World Bank 1983, Guisinger 1978) and those dealing with the degree of bias in protective systems, for example in Sri Lanka and Pakistan (Stern 1984, Kemal 1983, Cuthbertson and Khan 1979).

Even from these attempts, however, a number of interesting issues arise. First, even if a single objective can be selected which stands as a measuring rod the question ought to be asked to what extent are the other, possibly lower ranking, objectives fulfilled. The market argument in liberalisation assumes that the need to separate objectives in economic and social terms will be eliminated (if not reduced). In distorted markets however these objectives were often incompatible as, for example, in monopoly where profit maximisation implied sub-optimal output and employment levels and high prices. Even if SOEs were established in distorted markets there was a trade-off between economic and social objectives. Nevertheless, measuring the post reform effects would entail measuring all aspects, full and partial objectives, and even if the relative weighting assigned to each objective changes in the pre- and post-reform era, the significance of the trade-offs will still need to be noted.

Second, while there is little doubt that some criteria, such as financial profitability, represent important criteria for measuring private sector performance, this must not obscure the possibility that whether profitability can be taken as a proper measure of performance may depend crucially upon other factors, such as market structure (Kirkpatrick, Lee and Nixson 1984). In this case there is concern with whether the existence of competition, either from domestic or international origin, is sufficiently generated as a result of the reforms to permit prices to provide an appropriate measure of costs and benefits. If there is insufficient competition then profitability will be a poor guide to efficiency. Relatively weak levels of competition in manufacturing sectors can be found in many LDCs, for example in Pakistan and Sri Lanka where, in the latter, over a third of the manufacturing sectors show low levels of competition (Cook 1983, 1985).

Third, the efficacy of the policy objectives may be questioned when account is taken of their global implications. Estimates have already been made to show the infeasibility of most LDCs repeating the NICs (newly industrialised countries) achievements in world markets (Cline 1982). Further, the limitations of rapid expansion from the technological point of view have also been questioned (Kaplinsky 1984).

Implementation of reforms

At this stage, given the plaucity of direct attempts to measure the effects of liberalisation on industrial development in general, it might be apposite to examine a number of features which may make the implementation of reforms difficult to achieve. As discussed earlier, the mixture of objectives and interests becomes of paramount importance. Table 3 illustrates this by categorising some of the factors that affect implementation into economic, policial, social and administrative.

Although attempts to measure the impact of liberalisation itself are lacking, a number of attempts have been made to assess the degree to which the instruments themselves have actually been implemented. For example, despite the introduction of liberalisation measures on the trade side since 1977 in Sri Lanka it has been estimated that the reduction in bias for imports and against exports has changed only marginally (Stern 1984, Cook 1985). In this case other policy measures offset the intended effects of liberalisation.

Table 3 lists numerous factors that impinge upon the implementation of market oriented changes in policy. Although within each category a large number of elements exist, certain general principles emerge. First, as was shown above, in the economic category the existence of off-setting policy will affect the extent to which any policy instrument achieves its intended outcome. The contradiction in export policy in Sri Lanka may be cited here. On the one hand the government is attempting to reduce protection in order to stimulate exports, but at the same time the Export Development Board, which uses funds to provide incentives to exporters does so through the Export Development Fund, which is financed by maintaining protection through a cess collected on dutiable imports.

Another important aspect in this category is the initial degree to which markets are distorted. The East Asian economies were more able successfully to combine productive efficiency with low wage labour by adopting appropriate exchange rate policies and export promotion because they had not gone down the import substitution path very far and hence did not have very distorted markets (Duesenberry et al 1981).

Mispecified or incorrect functional relationships between policy instrument and economic variable will also be important. For example it has been argued that the disincentive effects to some producers of import substituting industrialisation led to a strong counter emphasis on a return to efficiency criteria. This reversal of economic policy was in many respects in direct conflict with the preferences of the main groups able to exert political opposition. This is the case whether we are discussing distortions in factor or product markets (Sheehan 1980). It must not be forgotten, however, that both the degree of adverse effects and departure from pure market criteria even within import substitution policies did vary widely between countries and, therefore,

TABLE 3 : FACTORS AFFECTING IMPLEMENTATION OF LIBERALISATION

| Policies / factors | Removal of market distortion | Changing public/private mix | Market development |
|---|---|---|---|
| Economic | - Offsetting policy so bias remains.<br>- Budgetary consequences of distortion removal.<br>- Conflict in stabilisation and development objectives (eg.rate interest).<br>- Too stringent assumptions not applicable to real world.<br>- Low initial level of distortion. | - Need for scale economies.<br>- Inadequate regulation and monopoly control.<br>- Fear of foreign investment. | - Poor infrastructure (eg. site and services).<br>- Uncertainty in power supply.<br>- Unrealistic export targets and lack of foreign exchange. |
| Political | - Strength of political interests served by distortions(eg.low rate of interest).<br>- Concern for intervention<br>- Distribution.<br>- Accepting reforms to acquire loan and then not fulfilling target. | - Loss of control of vital sectors (strategic).<br>- Loss of control of important instruments of patronage.<br>- Uncertainty over governments intentions(threatening legislation).<br>- Resistance to cut public sector as well to keep revenue.<br>- Willingness to sell loss-making enterprises but keep profit-making SOEs. | - Conflicting interests for resources (eg. irrigation v. industry). |
| Social | - Consumer lobby to distortion removal (Trade Unions.)<br>- Concern for efficacy of market provision of social objectives or alternative policies. | - Financial versus social objectives.<br>- Adoption of strategies (basic needs) requiring direct intervention. | - Destroys traditional livelihood, adverse effects on cultural factors through competition (technology). |
| Administrative | - Cumbersome administrative network.<br>- Overlapping administrative responsibilities(eg.implementing conflicting measures). | - Lack of knowledge.<br>- High cost of transfer.<br>- Shifting responsibility (eg.shifting loss-making SOE funding to private banks).<br>- Pursuit of own interests.<br>- Reluctance to lose resources to bureaucratic growth and control. | - Discretionary nature of decision-making.<br>- Corruption (in use of infrastructural aid). |

led to variable degrees of policy reversal.

Political factors feature strongly. In Latin America it has been argued that structural characteristics, such as unequal income and land distribution and poor infrastructure are such that political obstacles have been established on the one hand to prevent the implementation of new programmes while, on the other it has often been necessary to implement reforms through some form of political repression. It has been suggested that in some cases the existing distortions of the economic structure and in the system of incentives may be so extreme that it becomes inevitable that political repression is associated with the implementation of economic policies needed for growth (Sheahan 1980).

The factors influencing compliance with policy reforms are complex. In some cases they may relate to the severity of the consequences and, especially in relation to reforms externally induced through elements of conditionality, they may be related to the harshness of conditions. The conditions imposed by the IMF seem to have hardened after 1981 following the increase in the LDC debt problems (Killick 1985, 1985a, Dell 1985). It has also been shown, again particularly in relation to conditionality, that compliance is reflected in a recipient country's relative bargaining strength. LDC governments may in some instances accept the conditions that go with a lending arrangement but have no intention of undertaking the stipulated policy reforms, the intention merely being the rapid acquisition of financial resources to alleviate short term problems (Mosley 1984).

Social factors, besides the resistance of adversely affected groups to reform, may be prominent due to historical and structural characteristics. In many LDCs although multiple objectives in government policy exist, the range of policy substitutes is fairly narrow. This is clearly the case for instance with redistribution. Weak taxation systems, both in terms of coverage and delivery, have meant a greater reliance on SOEs in this capacity. A movement to a more market oriented system either presumes that there is an increased administrative and economic capacity to redistribute via the fiscal system, or that the weight in this area becomes less important. It could also be argued that overall narrowness and lack of competition, especially in the public policy area, may itself very well lead to weak administration and competition, acting as an obstacle to reform.

Poor implementability may not only be a consequence of the multiple objectives established by LDC governments. Conditionality imposed by lending agencies may also be subject to competing objectives. For instance, the requirement to increase competition based on efficiency arguments is constrained, to some extent, by the need to maintain fiscal levels (e.g., maintenance of import duties), to maintain existing social services, and to prevent a decline in well-being.

Structural considerations may also be important, particularly in the social sphere. It has been argued that in some LDCs where incomes from primary production, besides representing a large share of the economies income, are channelled mainly to large land owners (e.g., as in Argentina) and where the poor are predominantly found in urban areas, then reducing high tariffs to eliminate the distortive effects in protection could be at the expense of the urban poor. This is because reduction in tariffs will alter the relative price of industrial goods and improve the relative price of primary goods implying a relative gain to large landowners and a relative loss to the urban poor.

The administrative system itself may also represent a formidable constraint, (not only in the sense that the administrative machinery is weak and open to corruption) but especially where the system can circumvent changes as opposed to implementing them (Gould and Amaro-Reyes 1983). An illustration will be useful here. In an attempt to move the SOEs to a more market oriented approach, the Sri Lankan government has eliminated the direct subsidies to loss making SOEs. Instead the SOEs must seek funding from commercial banks. This is seen as a first step to making SOEs commercially viable, except that in this instance, the banks are compelled to bale out the loss making enterprises by not strictly applying commercial criteria to lending. In effect, then, the government has shifted the responsiblity for funding SOEs from the treasury to the banking system, which in its present mode of operation will have little impact on improving the commercial viability and efficiency of the SOEs (Cook 1985).

There is often a naive view of the implementability of some policies. Experience has indicated that privatisation does need regulation even though the arguments provided for operation in the private rather than the public sector are sound, and that decisions to privatise are often made disregarding the fact that regulators themselves may be efficient at what they do but that they nevertheless often pursue their own interests (Shackleton 1985). This is equally true of price control and incentive schemes.

## CONCLUSIONS

A number of concluding points can be made that are relevant to policy implementation.

First, although the types of policies have been categoried into three broad groups, (distortion removal, changing public/private mix and market development) there has been no systematic attempt to assess the relative importance of each type in the current wave of liberalisation. For example a review of the World Bank's sectoral and subsectoral concerns for structural adjustment and development show that all three feature equally prominently. These cover (a) the industrial policy framework within which industry operates and expands, as determined by tariffs,

import licensing systems, and investment promotion schemes. (b) the relative roles of the public and private sectors in economic activity. (c) the way markets are permitted to develop or are organised by governments. (Please 1984). Although all to some extent are concerned with price relativities. Again IMF conditionally has emphasised the importance of price correction in tackling both demand and supply side problems (Killick 1985). Nevertheless, even though the shortcomings of this approach have been pointed out as a solution to supply problems, the importance of non-price measures such as improved infrastructure, access to credit facilities and improved market knowledge must not be overlooked.

Following from this is the need also to assess the relative success rate of each of the measures. While Table 3 is illustrative of the way a number of factors can act as a constraint towards the achievement and implementation of reforms, it is only useful to policy makers if for each policy component an assessment of the relative strength of the opposing economic, political, social and administrative forces can be gauged. In this way more effective policies can emerge by matching the relative strength of policy instruments (measured in terms of their success rate) with the relative strength of the likely resistance to their implementation. In this approach could be included not only domestic constraints but external ones including the extent of world protectionism, the difficulties over technical transfer between industrialised countries and LDCs and the constraints to establishing significantly greater South-South trade in the short run (Collins 1985a).

To some extent an assessment of this nature would pre-empt the need for compromise when implementation difficulties are met. For instance, in Mexico in 1976 following the adoption of a more market oriented approach through devaluation, both labour and adversely affected business interests expressed bitterness over the resulting reduction in real wages. As a result the government had to compromise by negotiating wage increases that would to some extent, offset the impact of the devaluation (Sheahan 1980).

The need is then not just a matter of lessening the social or political strain to permit compliance but moving towards a more comprehensively established policy approach that is more aware of both the interconnected nature of many of the policy measures and of the breadth and relative strength of the resistances. To some extent this type of change is already taking place in World Bank programmes (Nelson 1984).

Finally there is a need in all the policy areas continually to evaluate the relevance of the arguments supporting policy. For example the arguments supporting state control of natural monopolies can only be defined with reference to a particular technology at a stage in time (Heald 1985). Changes in technology can create opportunities for competition which did not exist before. Indeed, theoretical advances in the

analysis of 'contestable' markets have brought an appreciation that the association between scale economies and natural monopoly is not as straightforward as generally thought (Baumol). Again, on the broader level, as the history of thinking in relation to industrial development in LDCs has shown, what appeared rational at one point in development became irrational in another.

Prevalent thinking at the end of the 1960s focussed on the special attention, (not necessarily in terms of quantitative restrictions and controls but via taxes and subsidies) that industrialisation needed (Little, Scitovsky, Scott 1970). This was justified on the basis that the task of government was not to fight the imperfections of the market mechanism by restrictions but to help the market by more government action in the form of monetary and fiscal measures, monopoly control and wages policy.

However, there was always the danger in manipulating the price mechanism for the purpose of removing distortion (e.g., insufficient incentive to industrialise) which may be inherent in its uninhibited operation, that another distortion (e.g., insufficient exploitation of the advantages of trade) is introduced. The danger is that too much interference or too much incentive is given, creating a bias against other sectors.

By the mid-1970s this became a focal point. Concern for the effects of tax and subsidy schemes on product, capital, and labour markets was evident in a number of studies (Balassa 1975). The policy implications have now culminated in a number of policy scenarios much more acutely focussed on a 'laissez-faire' approach, where policies take on a purportedly neutral role (e.g., equalising effective production rates at low levels).

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## NOTES

1. A more recent catalogue of LDCs experience with privatisation can be found in a recent issue of the 'Economist' Dec/Jan 1985/86.

2. Given such arguments it does appear that judgements about the rationality and irrationality of intervention in the real world are difficult, especially when viewed in an historial vacuum.

3. We are considering only general trends, Zaire has recently pursued policies in the opposite direction by setting up state enterprises.

4. Similar indexes relating to the degree of distortion in specific markets for capital and labour have been derived separately. See Gusinger (1978) for Pakistan. Caution is, however, needed in developing lending criteria based on the relationship between distortions

and growth. Agarwala (1983) finds price distortions to be one of a number of factors expalining variations in growth rates across countries.

5. This occurs through formal exchanges at executive level and in the dissemination of country papers, research and working papers between the main lending institutions.

6. Cowan, G.(1985) 'The American perspective on privatisation'. Presented at a seminar organised by Deloitte, Haskins and Sells, London, 16 October 1985.

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