MARKET-BASED
STRUCTURAL ECONOMIC REFORM:
An International Survey

Prepared for

The Center for International Private Enterprise

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THE CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

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The Futures Group is a research and management consulting firm specializing in future-oriented policy analysis. It was formed in 1971. Members of its staff are skilled in economics, demographics, political science, history, sociology, market research, social marketing, physics, chemistry, anthropology, the humanities, law statistics, systems analysis, engineering, and computer sciences. Studies are performed by The Futures Group for private and government clients in the United States and abroad.

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PREFACE

Starting in the early 1980s, a number of developing and socialist economies launched market-oriented structural reforms. The debt crisis and economic shocks of the 1980s forced a reassessment of previous import-substituting strategies in Latin America and Africa. Since the dramatic political events of the fall of 1989, Central and Eastern Europe and the Soviet Union have undertaken wide-ranging economic changes. Even the developing countries of East and Southeast Asia, which have long been more market-oriented than their developing country counterparts, have taken steps to further liberalize their economies.

Among economists, there is a broad consensus on the benefits of such reform efforts, even if there are disagreements about the timing and sequencing of particular initiatives. A number of studies have attempted to assess the economic effects of reform programs. Few, however, have attempted to measure the extent of implementation, or analyzed the political and institutional settings in which such reforms have been launched.

In 1990, the Center for International Private Enterprise initiated a comparative study of the reform process in 26 developing and 4 socialist economies in transition. The purpose of the study was to provide basic information on the chronology of the reform process, to assess the progress of reforms, and to reach some conclusions concerning the relationship between program design, institutional and political setting and successful implementation.

The purpose of sending this document out to you now is to widen the circle of debate, and thereby draw in opinions from policy makers, economic analysts, members of the media, and those in academia. This document is being sent to over 200 individuals and firms in the developing world and to the international business and aid communities.

Without the contributions and critique of those now undergoing or considering economic reform, our final analysis would lack impact and credibility. The door is open. We are well aware of the provocative nature of what follows: we welcome all reactions.

Please send any comments, questions, hypotheses or criticisms to:

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The range of measures that fall under the term "structural adjustment" or "market-oriented reform" is quite broad, and the terms are often used quite loosely. To assess the progress of reforms, it is important to differentiate between different reform areas. Four clusters of policies can be distinguished.

The first is the problem of stabilizing the economy and re-establishing a sustainable external position. A number of countries have suffered from high, and even hyper, inflations in recent years. The shocks of the 1980s, and in particular the withdrawal of international commercial lending, have aggravated balance of payment problems across the developing world and led to foreign exchange crises. The most important policy areas in this regard are fiscal and monetary policy and exchange rate adjustment.

The second broad area of policy reform concerns prices and the introduction of market forces. In both socialist and mixed economies, governments have intervened extensively both in the setting of domestic prices and in protecting the domestic economy from international competition. Key reforms in this area are trade liberalization, the lifting of wage and price controls, and the liberalization of financial markets.

The third task governments face is in restructuring important economic sectors, including the privatization of state-owned enterprises and improving the incentives for foreign investment. In a number of countries, governments have intervened in the productive process through the creation of enterprises, many of which are characterized by extensive inefficiencies. The socialist countries face particularly daunting problems in this regard, since virtually the entire economy has been in government hands.

The final, and perhaps most important, task is in creating the enabling legal and institutional environment required for markets to work. These reforms include, most fundamentally, the guarantee of property rights. Other supportive measures include legal and regulatory reforms and the provision of unemployment insurance and other social programs that are important for political as well as economic reasons.

During the summer of 1991 CIPE will be reviewing and analyzing the information contained in this volume. The finished analysis will be published in late 1991, and widely distributed. Our audience is, primarily, the policy makers in developing countries, the media, the academic community and others (e.g. the business and the international aid communities).

As a final word, as you read through this document, keep in mind that what we have measured here is not economic growth *per se*, but rather the intensity of effort in reform programs. However, in completing our analysis, we will of course be sensitive to the need to relate the intensity, duration, and consistency of reform to the bottom line questions of economic performance. In analyzing the data, we will be guided by the following key questions:

* What are the best reform strategies?
* Does the timing and sequencing of key elements affect the reform program?
* Is there a best method for introducing reforms?
* What are the key decision points in implementation?

William T. Archey
Vice President
Center for International Private Enterprise

INTRODUCTION

The Futures Group (TFG) is pleased to submit this Survey of Structural Economic Reform to the Center for International Private Enterprise (CIPE). This report is an attempt to demonstrate the extent of structural reform progress in 26 developing and 4 socialist countries in transition. In addition, this report attempts to shed light on the important issues of reform timing and sequencing, which are universally acknowledged to be critical factors in the success or failure of reform programs. The importance of multilateral assistance, privatization, foreign investment reform, national political leadership and institutional development are among the other key reform factors examined in country contexts.

The heart of this survey are the country chapters, which chronicle and assess 30 reform experiences. Each chapter contains narrative sections made up of an executive summary, a brief background description of reform antecedents, a detailed chronology of reform events and an analysis of reform timing and sequencing. Following each narrative section are the Structural Reform Matrices used to evaluate country reform performance (described below) and data tables depicting national economic performance in the pre-reform and reform periods. For the sake of consistency and cross-country comparability, the bulk of this data is drawn from International Monetary Fund and World Bank sources. Country and other published sources have been used with care. (See Section IV, Sources).

One's ability to effectively assess reform experiences hinges on the availability of policy information. Not surprisingly, the distribution of in-depth case studies is highly skewed in favor of countries that fit at least one of three descriptions: large economies, highly successful economies or ambitiously reforming governments. Most African countries do not fit into any one of these categories. Detailed information on their reform experience is consequently limited. Despite this limitation, in all cases, the TFG team managed to gather sufficient data to perform a basic evaluation of reform progress.

Finally, TFG believes that the findings of this study will be an important contribution to the debate on how governments should pursue market-based economic policies.

This report has been organized into three sections:

- Section I is an executive overview in which the TFG study team has drawn, from the 30 case studies, some preliminary observations and tentative conclusions on the progress, problems and promise of structural economic reform. This section is intended to help guide CIPE's follow-on research and investigations.

- Section II contains the country case studies, organized by region and alphabetically.

- Section III contains the SRM worksheets organized in matrix form, by region. The matrix format is intended to allow easier cross-country comparison of reform progress by specific policy option.

METHODOLOGICAL NOTES

The Structural Reform Matrix

TFG recognizes the inescapably judgmental nature of assessing and comparing levels of progress in economic policy reform across a very wide group of countries. To attenuate the possibilities for inconsistency and arbitrariness, we have developed a simple model that blends quantitative and qualitative measures of performance on key structural reform policy categories. This model, or framework for analysis, is called the Structural Reform Matrix (SRM).

In line with the overreaching goals of this study, the TFG study team used the SRM to measure a country's commitment to the structural reform **ideal**. The SRM does not measure an economy's response to policy actions; nor does it measure mere intention. **Instead, the SRM seeks to measure government actions and degree of effective policy implementation without regard to policy results**.

To understand the extent of reform progress that has taken place in any one country, two time periods have been delineated. For the sake of simplicity, these are labelled "pre-reform" and "reform" periods, although these descriptors do not in all cases fit. (For instance, Peru never really had an "orthodox" structural reform period.) The TFG study team, to the greatest extent possible, set time periods according to decisive policy changes—typically a new reform program or some other indicator of change or intent to change. Unavoidably, these period designations contain a high degree of arbitrariness.

A critical step in the development of the SRM was deciding upon the best set of reform indicators. Informed by an extensive review of the structural economic reform literature, TFG identified nine key **policy categories**: trade liberalization, foreign exchange management, financial market liberalization, wages and prices, fiscal and monetary policy, privatization, foreign investment, free flow of information and enabling environment. This list of nine categories was further broken down into **policy options**. TFG, in collaboration with CIPE and the Economic Reform Survey Advisory Team, further refined the list. Ultimately, 23 policy options, corresponding to the nine policy categories, were chosen.

Policy Weights

In an attempt to give greater importance to the more powerful policy options, a weighting scheme was developed for the SRM. Again, the structural reform literature was tapped for insights into the relative importance of the 23 policy options. From the onset, both TFG and CIPE agreed that the process of assigning weights was highly judgmental. There is simply no consensus of opinion on the relative importance of one policy option over another. Yet, the exercise is useful, if imperfect.

The total of all weights is 100. The weights run on a scale of 1 to 9.

Performance Ratings

Performance ratings are the essence of the SRM. **A rating represents the degree to which a country has, in practice, embraced the reform ideal.** In an improbable and extreme case, eliminating absolutely all tariffs would yield a rating of 100 percent for the "Low and Uniform Tariff Barrier" option. In practical terms, even highly open and liberal systems maintain some tariffs. Thus, a rating of 90 percent fits aggressive reformers that maintain minimal tariff protection.

In general, where a performance rating of 100 percent represents complete adherence to the reform ideal:

- A rating of 80 percent represents very high performance
- A rating of 60 percent represents high-moderate performance
- A rating of 40 percent represents low-moderate performance
- A rating of 20 percent represents low performance
- A rating of 0 percent represents no commitment.

Gradations along this scale are in 10 percent increments for the sake of simplicity.

To make rating assignments more precise, consistent and transparent, concrete indicators have been sought to measure depth of commitment to the reform ideal. Base indicators used by the TFG study team appear in Table 1.

For example, to measure "low and uniform tariffs," the study team assessed external tariff rates, the number of tariff categories and transparency of tariff rules. Likewise, to measure "real positive interest rates," commercial interest rates were examined over the review period in relation to inflation.

Tariff and interest rates are fairly concrete indicators. They lend themselves to consistent cross-country comparison. The same cannot be said for the policy options falling in the "Enabling Environment" category. These are highly judgmental options.

Indicators such as "Equal Access to Capital" and "Increase Tax Collection" tend to be highly judgmental as well, since the actual application of rules and regulations can be very different from what is "on the books."

A single performance rating is assigned for each period— the pre-reform and reform period. The rating indicates policy performance for the entire period. It is a composite picture, not a snapshot of the best or worst part of a given period.

In assigning a rating for a given policy option, each country analyst considered, for each period:

- **Intensity of reform effort**
- **Length of engagement in reform activity**
- **Consistency of action**
- **Effectiveness of message to markets**

Performance Scores

The policy weight (the relative importance of each policy option) multiplied by the country rating (the degree to which a country has embraced the reform ideal) generates a total reform score for each policy option. The total score is the sum of the 23 individual policy scores. This single score summarizes the country's reform effort relative to the ideal, maximum score of 100. An overall score of 90 suggests a high level of commitment to reformist policies. Scores of 30 or below suggest high levels of government control.

The mean reform score is the simple mathematical average of the 23 individual performance ratings.

The final SRM cross-country matrix lays out the policy option ratings and scores across countries. The presentation is by region: Africa, Asia (including Turkey and Jordan), Latin America, and Central and Eastern Europe (including the Soviet Union).

A Word on Staffing

The analytical work of this study was undertaken by a core group of four senior TFG professionals with experience in international economics, policy analysis and management science. Supporting them was Michael Kaser of Oxford University's Institute for Russian, Soviet and Central and Eastern European Studies, who managed the data gathering and analysis for the Soviet Union and Eastern Europe.

Table 1

SRM PERFORMANCE RATING INDICATORS

Policy Option	Performance Indicators
Low/uniform non-tariff barriers	Existence of quotas, import reference prices, import licenses, restrictive foreign exchange regulations, discriminatory quality standards
Low/uniform tariff barriers	Average tariff rates Tariff ceilings Number of tariff categories Clarity in rules Consistency in implementation
Local content regulations	Mandatory requirements or market-distorting incentives to utilize local inputs
Market determined exchange rate	Number of exchange rates Government intervention in the foreign exchange market Existence of a parallel exchange market Gap between free and parallel exchange rates Real effective exchange rate over time
Minimal exchange controls	Extent of restrictions on capital transfers, import operations, remittances, hard currency bank accounts, etc.
Market-driven real interest rates	Maintenance of real positive interest rates
Minimal preferential interest rates	Distorting effects of special credit program for exports, agriculture, development, etc.
Equal access to capital	Existence of discrimination in allocation of capital resources
Limited wage and price controls	Extent of official control over prices and wages
Minimal subsidies	Extent of subsidized goods and services; degree of effective targeting subsidies to benefit the neediest
Balanced budget	Deficit/surplus as a percentage of GDP
Reduction in marginal tax rate	Reduction in personal and corporate taxes to spur savings and investment
Equitable/uniform tax collection	Measures to promote more effective and fair tax collection

Table 1
SRM PERFORMANCE RATING INDICATORS (CONT.)

Policy Option	Performance Indicators
Divest non-strategic state firms	Actual sale or closure of state companies
Franchise state services	Turn over SOE management control to private operator
Simulated privatization	Enterprise decentralization Employment reduction and other cost-reducing measures Improved SOE management training Other efficiency and profit-maximization measures
Non-discriminatory treatment	Same rules of the game for foreign and local firms alike Equal incentives
Proactive promotion	Clear message of welcome to foreign investors Government sponsorship of trade shows Effective investment promotion administration
Information	Timely and reliable government statistics, regulatory and financial information Existence of a free press
Private property rights	Clear and enforced laws ensuring the right to hold private property Effective safeguards for intellectual property Adequate space for private owners to operate in; steps to reduce state sector reach
Efficient government administration	An honest, skilled and responsive government bureaucracy
Legal and accounting systems	Existence of legal and accounting Institutions Compliance with international norms and standards
Infrastructure	Existence of basic functioning infrastructure to support private business operations Government efforts to upgrade infrastructure

I. OVERVIEW OBSERVATIONS

The following are preliminary observations on structural economic reform experiences drawn from the 30 country case studies. These are intended to help guide CIPE's next stage of inquiry into the key factors and dynamics that drive successful reform program.

General

- As expected, countries that have put off adjustment have experienced more painful and difficult stabilization. Good examples of this are Venezuela and Zambia, both hit hard by exogenous shocks and both forced to swallow harsh adjustment medicine after having postponed change.

- Contrary to public opinion, there has been considerable progress toward structural economic reform in the great majority of the 30 select countries. Progress was not necessarily an economic turn-around - but was instead progress in the reform of institutions, laws, and regulations which promote reform. Figure 1, which is based on the weighted SRM results, suggests the extent of this progress. Particularly salient is the extent of changes in selected African and Central and Eastern European countries albeit from very low starting points. Peru is the sole example, among the 30 countries, of retrogression between periods.

- These reform efforts are still tenuous and, in most cases, vulnerable to internal political pressures. There appears to be a tremendous need for effective communication of reform objectives and likely reform results. Unrealistic expectations for short-term results need to be changed. Likewise, the benefits of sustained reform need to be credibly articulated.

- The scope for drastic policy reversals is limited by foreign debt burdens, conditionality imposed by creditors, and severe fiscal policy constraints. The "old way"— import substitution industrialization, state enterprise, etc.— is seldom seen as viable, even by opponents of aggressive market-based reform.

- Based on the data used in the survey, the IMF and World Bank have played prominent roles in all of the apparent success stories. Paris Club and London Club support has kept many African reform programs on track. Countries that have tried to "go it alone" have failed to stabilize and recover.

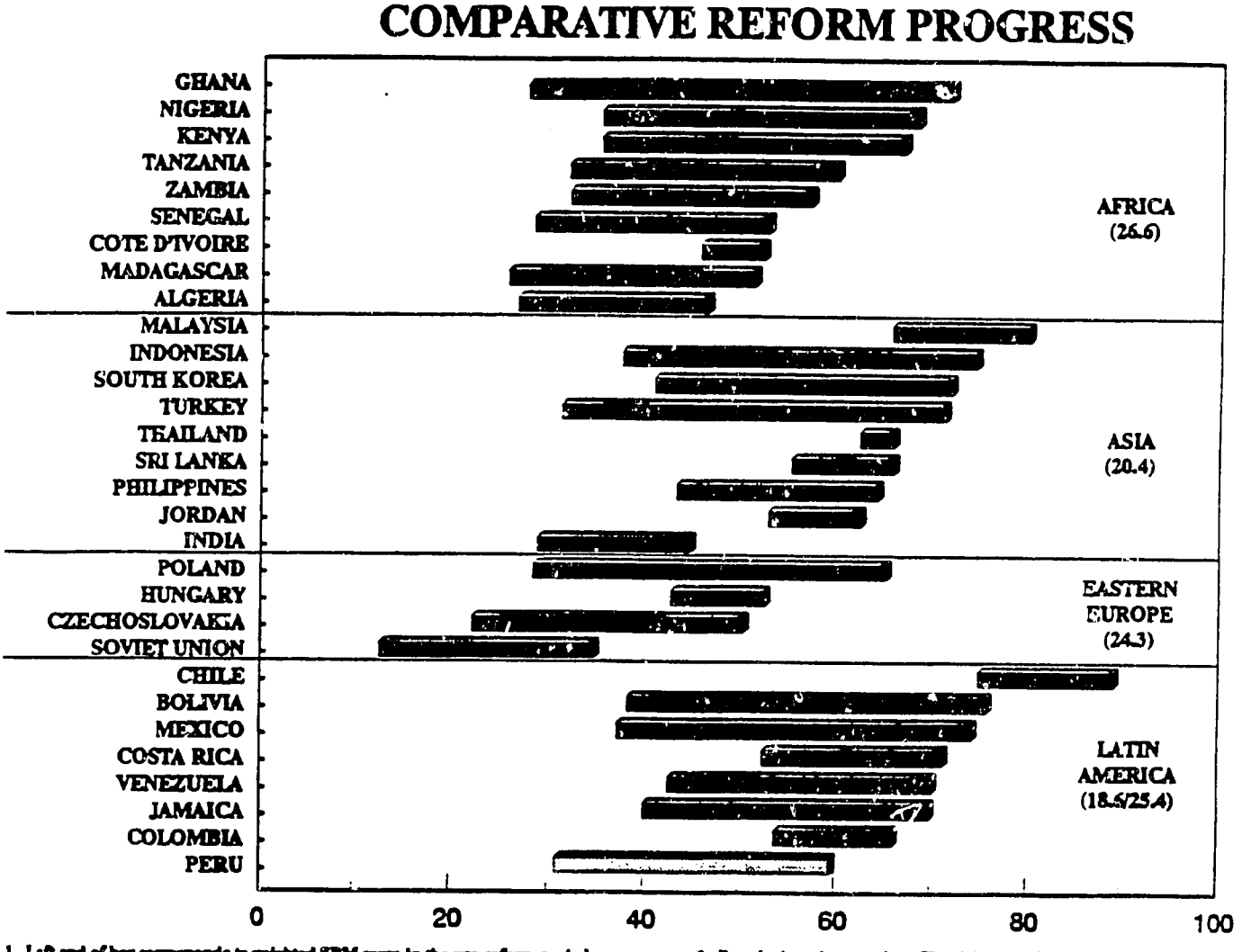
- The economic payback of serious reform efforts are elusive in the first few years of a program. The effects take time as the structural deficiencies are corrected. Also, investors need to be convinced that the reforms are real. The more prolonged the period of pre-reform mismanagement, the longer investors will

sit on the sidelines. Without credibility, recovery will not occur and structural reforms will be steadily eroded. Unrealistic expectations for short-term results need to be modified.

- The right price incentives can produce surprisingly rapid results. This is especially true for exports when export market conditions are favorable. Poland and Mexico became overnight export success stories once they competitively valued their respective currencies.

- Regional differences in reform experiences are salient. Latin America and Africa are laboring under heavy debt burdens and greatly reduced per capita income since the 1980s. Many Asian countries underwent reform earlier, and now operate without the huge debt overhang and with the benefit of economies already export-oriented.

Figure 1



1. Left end of bar corresponds to weighted SRM score in the pre-reform period, right end of bar corresponds to weighted SRM score in the reform period. Thus the relative extent of progress is captured by the length of the bar.

2. Peru is the sole exception. The right end of it's bar represents the pre-reform period. Thus Peru registered negative results for it's reform.
3. ( ) figure is the average reform progress. LA is figured W/ and W/O Peru

Political and Institutional Environments

- Structural economic reform has taken root in a wide range of political systems, but stability is crucial.

- A common factor in all successful reform experiences has been a strong executive. Often national leaders enjoy augmented power during a stabilization and adjustment experience. This can prevent crucial reform measures from getting bogged down in partisan wrangling. Even more important, strong executive leadership can prevent obstructive behavior on the part of the bureaucracy, which more often than not has a vested interest in maintaining the status quo.

- Although structural economic reform has been able to flourish in a variety of political systems, there does not appear to be a consistent relationship between types of government regimes and economic reforms. Authoritarian political systems, by limiting and controlling debate, can be favorable environments. However, as the democratic experiences of Poland and Bolivia suggest, democracy can, in some cases, be a prerequisite of radical reform.

- New democracies are extremely difficult economic environments in which to launch reform efforts. New, popularly-elected regimes often enjoy significant policy freedom during their initial "honeymoon" periods. In time, however, newly empowered political groups place demands on the system, which can be at odds with the reform agenda.

- Reforming governments need reform constituencies, which are hard to build when change threatens key stakeholders, particularly government bureaucracies and local business groups. Some reforming governments have cultivated backing in the more modern, export-oriented sectors to counter anti-reform pressure from old line business groups who prospered under import substitution. In successful cases, governments have garnered support from those who are beneficiaries of the reforms.

- "Social contracts"— often tripartite pacts between government, business and labor— have been successfully deployed in some circumstances to build consensus and broad-based support for reform. They are not panaceas, however. Some governments see these arrangements as dangerous invitations to dissent and challenge.

- Strong government institutions are vital to structural reform. Countries can achieve short-term macroeconomic objectives under a wide range of institutional arrangements. But effective institutions, with technically proficient bureaucrats, are required to truly transform economic systems.

- The technical requirements of reform are significant. This puts at a disadvantage smaller, poorer countries that have fewer resources to retain competent bureaucrats. One consequence of this could be a larger IMF role and profile, which can be a political liability for the government, which has an interest in ensuring that the reform program appears "home grown".

- Central and Eastern Europe and Soviet reform programs are at a disadvantage without an experienced cadre of Western-trained economists and technocrats to manage the reform process. These Eastern European economic leaders are still learning to cope with the new and unfamiliar market mechanism. In contrast, the current generation of Latin American technocrats hold advanced degrees from top U.S. universities and for the most part have first hand knowledge of mixed economies.

- Political liberalization in certain economic reform contexts can be used as a bargaining chip to further reform programs. In Algeria and Jordan, for example, the government maintained support for reform programs by granting greater economic freedom.

- In many other cases, political liberalization and economic reform are a volatile combination, when launched simultaneously and intensely. The extreme case is the Soviet Union, where the government was clearly unprepared for the consequences of political reform. Prospects for broad, intense economic reform seem to have died in the process.

- Corruption undermines political institutions and economic systems. Yet few governments have waged successful campaigns to eradicate it. It is an institutional problem that does not lend itself to aggressive frontal assaults, which can be destabilizing.

- De-regulation and privatization help promote government efficiency by removing opportunities for corruption and rent-seeking. The privatization process, however, can itself invite official kickbacks and other improprieties if not properly regulated and supervised.

- Paradoxically, newly liberalized markets often require new and different types of rules and regulations. This is especially true in the case of monopolies, which have to be supervised. Newly liberalized financial markets also require effective policing. Reforming countries rarely have experience in these areas and often require external assistance.

Regional Problems and Priorities
(Based on 30 sample countries)

- In Central and Eastern Europe, basic institutional reforms providing private property rights have been rightfully placed at the top of the reform agenda. Privatization is critical to this process unfolding.

- Africa, in contrast, is heavily dependent on state companies for employment and production. There do not exist ready buyers for African state companies. Foreign investors are reluctant to come in and take the risk. Often the return in these poor countries cannot be justified.

- In Africa, there has been a heavy emphasis on sectoral policies— economic diversification, price liberalization and infrastructure development. Pro-agriculture policies, particularly with regard to pricing, credit and technical assistance, are correctly identified but inconsistently implemented.

- African reformers have an acute need for debt relief. Also, until economic diversification is achieved, they need financial mechanisms to buffer them against sharp commodity price downturns.

- In Latin America, which suffers from huge debt service burdens and hyperinflation, export-promotion policies and fiscal reform are critical elements stressed in every serious reform effort.

- Regional integration in Latin America is seen as an efficiency-building mechanism for global competitiveness.

- In East Asia, pro-export economies like Korea's have already proven themselves to be highly competitive internationally. Greater emphasis there is put on internal market development, reducing entry barriers and liberalizing foreign investment access.

The Choice and Sequencing of Reform Policies

- In general, countries that move quickly and forcefully— rather than slowly and cautiously— have tended to experience greater success implementing and sustaining policy changes than the more cautious reformers.

- Rapid and forceful reform is not the same as once-and-for-all reform, however. No country has attempted to structurally transform itself overnight. Rapid and forceful reform means pushing out on all key reform fronts, and systematically and consistently building on these reforms over a period of years.

- In general, countries that had begun to adjust before the 1980s commodity price crises were able to successfully weather the shocks to come much more effectively than those countries that had not. Korea, Turkey and Chile fit this description of early reformers.

- Countries that have proceeded the farthest along the reform path tend to have the most successful fiscal management. In no case was a successful reformer successful in all other important policy areas except fiscal policy. Controlling the fiscal deficit is critical to maintaining stable prices and interest rates, and ensuring exchange market stability. Fiscal policy has a pervasive effect on economic performance.

- Trade liberalization and currency adjustments can be important instruments in the adjustment process. The most successful reformers have moved aggressively and simultaneously on these fronts. Credible programs do not preclude phased reform. For example, the most important first step of trade liberalization is removing quantitative restrictions. Tariffs can be rationalized and reduced as market conditions permit.

- Foreign investment liberalization runs through all successful reform efforts. Unfortunately, countries undergoing restructuring programs are often unattractive to new investors. Reforming markets are typically depressed and risk perceptions tend to run high. To compensate for these negative factors, debt-equity swaps have been successfully used in Chile, Mexico and the Philippines to coax new investment.

- Foreign investment liberalization and privatization are often pursued in the structural phase of reform, after basic stabilization and adjustment have been achieved. However, some countries have successfully pursued these liberalizations earlier, partly to ease adjustment strains. Privatization of large utilities, for example, can provide major cash inflows to fiscally troubled countries to help fund social safety net programs, among other things.

- Real positive interest rates are an important defense against balance of payments instability and thus should be in place early, during the stabilization phase of reform. When markets calm, they should be stubbornly maintained to boost savings and investment, and to win back flight capital.

- Heterodox reform approaches (involving strict wage and price policies) do not have a convincing track record. Under the Alan Garcia government, Peru enjoyed a short-term boom with the help of wage and price controls, but the economy collapsed soon after. Although not part of this study, Argentina and Brazil's mid-1980s heterodox experiments are also widely recognized failures. Mexico and Israel have mounted successful heterodox

campaigns, but not without strenuous policy discipline and significant external financial support.

- Financial market liberalization should not be attempted without proper regulatory controls in place. Both Chile and Sri Lanka experienced bank failures and financial crises after undertaking premature financial market liberalization programs.

- Effective privatization is extremely difficult, even in the best of circumstances. It has been observed that it took the British government ten years, with the benefit of one of the world's most developed financial systems, to privatize a few dozen companies. The contrast with Africa, where state enterprises account for as much as half of total national employment, is dramatic. It is not surprising that divestment has not been top on Africa's reform agenda.

- In Central and Eastern Europe, privatization is hampered by the absence of functioning capital markets. Several writers on Poland's reform efforts have underlined the importance of bank reform on privatization. They assert that without banking reform, privatization cannot ensure that scarce capital will be channelled to the firms that can utilize it most efficiently.

- Strong leadership and effective "safety net" policies are required in the poorest countries, where the adjustment burden is relatively harsher. Popular resistance to austerity measures is greater. It stands to reason that subsidy withdrawal needs to be more gradual in such environments. Multilateral agencies and donor nations have an important supportive role to play in helping these countries phase down subsidy programs.

- Capital and equity markets are important enablers of private capital formation, as Turkey's experience suggests. Vibrant capital and equity markets also send important signals to investors, local and foreign.

II. COUNTRY CASE STUDIES

ALGERIA

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ALGERIA

General Assessment of Reform

- **Algeria's structural reform effort has been moderate, cautious and limited in scope.** Reform of the public enterprise system was the key objective of the reform effort. Efforts moved from downsizing and decentralizing the EPEs, to having a public trust system provide a buffer between the government and the enterprise. All other structural economic reform measures (trade liberalization, banking reform, currency devaluation) were initiated to support the reform of the EPE system.

- **Reforms in the EPE sector have run deep.** Considerable autonomy has been granted to all but a few dozen "strategic enterprises" which remain directly managed by the government. Yet, while the EPE's more clearly resemble private enterprises there is little evidence to show that the changes have yet resulted in higher enterprise output. Also, the fact remains that the government still controls, albeit from a greater distance now, over 90 percent of the manufacturing and industrial base of the country.

- **Political reform is intimately entwined with structural economic reform.** Not only do new governments or cabinets foreshadow new policy directions, but changes in the political system are sometimes a response to essentially economic problems. As with the 1988 riots over the austerity measures imposed by the reform effort, the government responded with liberalizing the political front. This seemed to satisfy the public.

- **Financial sector reform went hand-in-hand with EPE reform.** The government recognized early on that a functioning and efficient financial sector was required if the reforms of the EPEs were to succeed. The government committed to upgrading the financial system while at the same time decontrolling it. These financial reforms directly benefited the EPEs by ensuring that the nation's financial resources flowed to the most efficient state enterprises.

- **Exchange rate and trade liberalization came late in the reform period and were not very ambitious.** These reforms, long stalled for political reasons, came about only on the recognition that they too were needed if the public enterprise reform was going

to succeed.

- **Algeria's adjustment burden was made heavier by its decision to forgo heavier IMF help (until very recently).** Multilateral credits would have strengthened its external and fiscal sectors. Moreover, an IMF program would have paved the way for private bank debt restructurings, which would have lightened Algeria's debt service burden. For political reasons (related to a nationalistic resistance to policies imposed from the exterior), Algeria opted against the IMF option until 1989.

- **Clear evidence of success related to Algeria's reform policies has not yet materialized.** Real economic growth has been negative or flat since the advent of structural reform policies in 1986. In addition, the nation's fiscal deficit is chronically high. Higher world oil prices resulting from the Persian Gulf crisis have proved short-lived. Algeria will not realize an extended oil revenue windfall. This means that structural reform efforts must go forward with the objective of making the economy's productive base more diverse and efficient.

I. Background to Reform

The Boumedienne era, from 1965 until 1978, was marked by rapid industrialization and radical collectivized agriculture. The orientation of policy was decidedly socialist. The basis for growth was petroleum exports, import substitution industrialization and substantial foreign borrowing.

By the late 1970s, structural problems in Algeria's development strategy became evident. The coming to power of President Chadli Bendjedid in 1979 began a period of economic reassessment and gradual reform centering on the large and inefficient state sector. A more pronounced reform drive was launched in 1986, when the world oil market crashed. Since that time, the reform process has gradually expanded beyond its original primary goal of decentralizing and modernizing the state enterprise sector.

II. Evolution and Chronology of Algeria's Economic Reform

1978

President Boumedienne dies in office.

1979

Chadli Bendjedid is elected as the new president.

1980

Chadli begins to dismantle the socialist structures built up in the 1970s under Boumedienne.

1981

Efforts to scale down and decentralize the largest public enterprises go forward.

1983

President Bendjedid makes a state visit to France— the first by an Algerian head of state. Several commercial agreements are reached as well as financial credits.

1984

President Bendjedid is re-elected for a second 5-year term. A cabinet reshuffle consolidates his power.

1985

President Bendjedid makes a state visit to the U.S.

The second 5-year plan (1985-89) is published. The plan emphasizes agriculture and water development over industry.

A bumper crop year for agriculture.

1986

A national referendum supports the national charter with 95 percent acceptance— effectively backing Bendjedid's policies.

Oil price collapse and the decline of the U.S. dollar sends the economy into a tailspin.

Many top ministerial positions are replaced by younger nonmilitary liberal reformers loyal to Bendjedid.

Modernization and liberalization of the banking system is initiated. Computer systems and customized accounts are among its new features. Foreign currency accounts can be held by anyone, including foreigners, for the first time.

25

1987

Legislation establishes autonomie d'enterprises or autonomous state-owned/public companies. This continues the downsizing and decentralization of public enterprises begun in 1981.

Privatization of state-owned farms goes forward.

The planning ministry is abolished. Companies and regional organizations are tasked with planning function.

1988

Thousands of young Algerians protest austerity measures.

Another fall in the price of oil, drought and a locust plague devastates the economy.

Popular referendum grants large support for the decentralization and democratization of Algerian society. Many political reforms are enacted as well— among them independent political parties.

The final stage of public enterprise restructuring is reached. Eight fonds de participation or public trusts hold shares in all the state enterprises now called enterprises publiques economiques (EPEs). Each trust is tasked with a specific sector of the economy though they can hold share from any EPE in any sector. The shares of an EPE are fully tradeable among the trusts. The trusts act as a buffer between the enterprises and the government and thus give the EPEs more autonomy.

Dinar is allowed to fall.

Five heads of state from Mauritania, Algeria, Morocco, Tunisia, and Libya meet to lay the groundwork for an "Arab Maghreb Union."

Passage of the National Credit Plan for 1989 strengthens the newly found autonomy of the Central Bank.

Trade restrictions are relaxed somewhat. Private companies can import on their own account rather than going through the government trading company.

A repeal of the law barring foreign companies from appointing

local agents or canvassing for sales brings a new class of foreign investors and local business people into the marketplace.

1989

A second meeting of the five heads of state formalize the Arab Maghreb Union (UMA). Joint economic projects and removal of economic barriers are the task of the union.

New constitution is enacted giving the right of political association (multiple political parties).
The Armed Forces of Algeria (ANP) withdraws from the ruling national party (FLN) over the 1988 riots in which some 159 people were killed. The FLN's reputation is tarnished as well.

The Bendjedid government's response to the FLN's declining popularity after nearly 30 years in power was:

The appointment of a new cabinet headed by Kasdi Merbah, who is known as a reformer
Opening the way for major political reform.

In a notable break with tradition, Algeria agrees to adhere to an IMF standby credit package. World Bank structural adjustment loan is prepared.

Further liberalization allows EPEs to have foreigners manage operations through sub-contracting or joint ventures.

New bonds denominated in dinars and francs are issued to coax large sums of unrecorded transactions into the formal banking system.

1990

First multi-party elections held since independence in 1962. Muslim fundamentalist party (FIS) wins a majority of the provincial and local seats.

New legislation covering credit and investment is passed. Limits on the level of foreign ownership in joint ventures are abolished. Capital repatriation is now allowed. Foreign banks and financial institutions are allowed to open branches in Algeria.

Labor law reform passes, doing away with collective bargaining arrangements.

The third five-year development plan is reported to allow the EPE sector almost complete independence in decision-making.

III. Analysis of the Reforms

A. Timing

- **The coming to power of the Chadli government in 1979 signaled a decisive change in policy away from a centrally planned economy.** The reform program that emerged was relatively modest in scope and intensity. Private sector development was more explicitly encouraged and steps were taken to modernize the country's huge bureaucracy.

- **The key catalytic reform event, however, was the reverse oil price shock of 1986, which caused a one-year 50 percent drop in Algeria's terms of trade.** The need for structural adjustment was compelling. In 1988, further shocks— another oil price drop, a drought, and a locust plague – kept the pressure on the government to sustain the reform drive.

- **Cabinet changes fueled the reform momentum.** After the 1986 oil price crash, liberal technocrats increasingly replaced old-line bureaucrats who had grown up under the heavily statist system.

- **Important political space was provided by the 1986 national referendum,** in which 95 percent of the electorate essentially voiced support for Chadli's reform policies. This provided a "green light" to officials to continue the reform process.

- **Political liberalization measures— and not reform backtracking— were the government's response to the 1988 anti-austerity riots.** This worked to quell the social unrest, but not without a cost. The FLN party's reputation was tarnished, and in the first multi-party election after the political reforms the FLN was soundly beaten by Muslim fundamentalist groups at the local and provincial levels. These groups may prove to be the FLN's first real political challenge in 30 years.

B. Sequencing

- **The lead policy reform in Algeria was the downsizing, decentralization, and simulated privatization of the vast public enterprise system.** This effort started slowly in the early 1980s and became more vigorous after the oil price crash of 1986. By 1990, important institutional reform had taken place, although this clearly stopped short of true privatization.

- **A modern and efficient banking and financial system was seen as a key component of public enterprise reform.** The effort to decentralize and simulate private ownership and control over EPEs required financial institutions capable of handling complex transactions in an efficient manner. Thus, financial system reform was undertaken in parallel fashion. The state invested heavily in the financial system while relinquishing some control.

- **The most market-oriented reforms occurred in agriculture, where farms were actually turned over to private ownership.** The government realized after the launch of the public enterprise campaign that agriculture was key to making the total reform effort succeed. While the population could stand to have changes in the structure of manufacturing jobs, they could not do without food during the period. The long-standing collectivized farm system never fulfilled its promise. Small-scale private farm ownership was seen as the way to boost both employment and output.

- **Reforms involving the exchange rate and the trade regime came late in the reform period.** These changes came about approximately the same time the final stage of public enterprise reform was being operationalized. The motivation for the trade and exchange reforms derived from the proposition that true EPE management autonomy required freedom to buy inputs from the cheapest sources— be they foreign or domestic. Thus, the exchange rate and trade regime were reformed to allow EPE managers to realize benefits from reduced costs resulting from more open trade arrangements.

- **Private enterprise was not significantly encouraged until late in the reform period—nor was foreign investment.** These changes

stemmed from the gradual realization by the government that continued dependence on oil exports was not a prudent development strategy and that private and foreign capital had an important role to play in the nation's economic diversification.

Structural Reform Matrix (SRM)
Worksheet for Algeria

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1985		Reform Period 1986-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	40%	3.6
		Low and Uniform Tariff Barriers	6	30%	1.8	40%	2.4
		No Local Content Regulations	4	30%	1.2	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	40%	3.6
		Minimal Exchange Controls	5	20%	1.0	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	50%	3.5
		Minimal Preferential Interest Rates	1	20%	0.2	50%	0.5
		Equal Access to Capital	3	20%	0.6	40%	1.2
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	50%	3.5
		Minimal Subsidies	4	20%	0.8	60%	2.4
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	30%	1.8
		Reduced Marginal Tax Rate	2	20%	0.4	40%	0.8
		Equitable / Uniform Tax Collection	2	30%	0.6	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	20%	1.0
		Franchise Out State Services	2	20%	0.4	80%	1.6
		Simulated Privatization	3	60%	1.8	90%	2.7
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	40%	2.4
		Proactive Promotion	1	20%	0.2	50%	0.5
2	Information	Free Flow of Market Information	2	20%	0.4	40%	0.8
16	Enabling Environment	Private Property Rights	9	30%	2.7	50%	4.5
		Efficient Gov. Administration	2	20%	0.4	40%	0.8
		Legal and Accounting System	2	30%	0.6	40%	0.8
		Infrastructure	3	70%	2.1	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	27.0	26.6	48.7	48.5

ALGERIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GNP:	1.4	3.5	4.0	5.8	4.0	5.4	1.0	-1.9	-2.8	--
By sector: Agriculture	13.4	0.7	-8.2	-0.2	4.4	27.0	5.6	6.8	-12.8	--
Industrial Activity	-1.7	0.4	8.7	1.7	3.9	4.9	1.6	1.8	-0.4	--
Services	2.3	8.7	0.3	11.6	4.3	2.1	-0.6	-6.7	-1.2	--
Per Cap. GNP-Current US $	1940	2250	2400	2410	2440	2560	2600	2630	2450	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	17.52	16.86	16.50	14.94	16.23	15.65	16.14	18.40	17.48	16.94
Purchesing Index, US=100	107.41	100.56	99.82	104.69	95.31	92.11	107.66	104.68	97.54	98.71
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Exports (fob) (1980 prices)	10.52	11.42	11.22	11.06	11.13	10.87	9.41	6.99	5.87	--
Imports (cif) (1980 prices)	13.87	12.87	12.98	13.65	14.24	14.92	16.28	16.10	16.99	--
Current Account	0.25	0.09	-0.18	-0.09	0.07	1.02	-2.23	0.14	-2.04	--
Capital Account	0.95	0.01	-0.79	-0.53	-0.21	-0.12	0.59	-0.31	0.74	--
Changes in Reserves	-1.11	0.08	1.27	0.52	0.38	-1.36	1.16	0.02	0.74	--
External Debt	19.24	18.38	17.60	16.05	15.10	16.48	20.44	24.39	24.85	--
Interest Payments (on foreign debt)	1.40	1.31	1.37	1.22	1.39	1.42	1.57	1.57	1.81	1.87
Export Growth %	-13.5	-7.2	0.9	5.2	4.3	4.8	9.1	-1.1	5.5	--
Terms of Trade % Change	45.8	13.1	-5.9	-7.3	-1.2	-0.7	-47.8	10.5	-27.1	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

ALGERIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	9.5	14.6	6.7	7.8	6.3	10.5	12.4	7.4	5.9	--
Fiscal Deficit (-)/Surplus as a % of GDP	-8.5	--	--	--	-9.1	-9.9	-12.2	-7.5	-10.4	--
Investment Share of GDP %	39.1	37.0	37.3	37.6	36.4	33.9	32.2	30.3	30.7	--
Savings Share of GDP %	43.1	40.7	39.2	39.7	38.8	37.3	28.8	32.1	31.6	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	--	--	--	--	--	--	--	--	--	--
Government Share in Economy %[2]	13.7	13.9	13.8	13.5	13.7	14.4	12.9	--	--	--
Gross New Foreign Investment (US mn$)	348.8	13.0	-54.0	--	1.0	--	5.0	4.0	13.0	--

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

COTE D'IVOIRE

COTE D'IVOIRE

General Assessment of Reform

- **Cote d'Ivoire has had an inconsistent and imperfect track record in committing to market-based structural reform policies.** The nation clearly has registered progress since the 1970s. In important ways, the economy is now more open and competitive, and less regulated. The state enterprise sector has been reformed and reduced somewhat. Private enterprise is now more forcefully encouraged. However, the nation has very modest economic results to show for its efforts. Working against progress has been a hostile external trade environment as well as Cote d'Ivoire's inability to respond effectively to these external weaknesses with policy measures clearly under its control— in particular, fiscal policy.

- **Regional exchange rate arrangements have constrained Cote d'Ivoire's adjustment options.** As a member of the West African Monetary Union, the nation has limited freedom and flexibility in exchange rate management. (The regional (CFA) franc is pegged to the French franc at a rate of fifty to one.) While Cote d'Ivoire could not take unilateral action, reports surfaced at the close of 1990 that the nation was considering some sort of unspecified devaluation. Independent of this discussion, Cote d'Ivoire policymakers have in the past been criticized for failure to more aggressively use an import surcharge/export subsidy scheme to compensate for the fixed, overvalued CFA exchange rate.

- **In the 1985-86 period, adjustment policy successes and favorable terms of trade combined to yield positive, but fleeting, results.** During this time, Cote d'Ivoire tightened fiscal and monetary policy, while erecting an export subsidy scheme (to compensate for a real overvaluation of the currency). The nation also arranged a four-year foreign debt rescheduling. In conjunction with rising export earnings, these factors produced a short-term recovery that peaked in 1985 with real GDP growth of 16 percent. After that, Cote d'Ivoire's economic progress fell victim to a heavy foreign debt burden, excessive government spending, an appreciating exchange rate and declining terms of trade. The domestic economy did not adjust to changing external conditions.

- **A unique feature of Cote d'Ivoire's adjustment effort was an attempt to manipulate its external economic environment rather than face internal policy changes.** The nation is the world's largest cocoa producer. When the world market price for cocoa tumbled in 1987, Cote d'Ivoire withheld cocoa supplies in an attempt to shore up world prices. Prices strengthened, but only temporarily. Faced with stagnant world demand and increasing numbers of suppliers, the nation abandoned the stockpiling policy in 1989-90.

- **Political uncertainty and social unrest may help explain Cote d'Ivoire's inability to fully sustain a reform program.** Unrest has been on the upswing since 1987 and grew protracted in the first half of 1990. The opening up of Cote d'Ivoire's political system was a cause of uncertainty, following the long-standing single-party rule of the PDCI. The nation's long-ruling octogenarian President Houphouet-Boigny himself contributed greatly to the uncertain environment by not promptly articulating succession plans, and then not following through on these plans.

- **Both the IMF and the World Bank have been heavily involved with Cote d'Ivoire, providing substantial financial backing and advice.** Fund involvement dates back to 1981, when it granted the nation a three-year extended fund facility. IMF lending continued throughout the 1980s, despite occasional suspensions in loan disbursements. The World Bank has provided three structural adjustment loans since 1981, as well as provided sectoral and energy loans. World Bank prescriptions are credited with having influenced Cote d'Ivoire's shift away from state intervention and toward private enterprise.

- **Debt relief and massive donor support have not figured significantly in Cote d'Ivoire's reform experience— perhaps owing to its increasing foreign debt arrearage.** This situation contrasts with other African nations similarly struggling with heavy debt loads and politically delicate reform programs. However, the policies taking shape under the new prime minister (who also holds economy and finance ministry portfolios), Allassane Dramane Ouattara, promises deeper and more sustained structural reform, leading in turn to more generous international support for Cote d'Ivoire's recovery.

I. Background to Reform

During the 1960s and 1970s Cote d'Ivoire experienced spectacular growth in national output and income. This growth was fueled by

high commodity prices, which boosted the nation's earnings from cocoa and coffee. The state marketing board acted as intermediary between high international prices and prices local farmers received. During these boom years, the state marketing board was able to "skim" windfall profits. The skimmed funds were used to fund the state's import substitution industrialization policies. Vast state-owned industrial and manufacturing investments were made during the period. Heavy foreign debt was accrued in the mistaken belief that commodity prices would stay high indefinitely.

The Cote d'Ivoire economy was highly vulnerable when a series of shocks and disasters converged on the country in the early 1980s. Prices for coffee and cocoa collapsed and demand fell as a result of the worldwide recession. The heavy borrowing during the 1970s to help finance overly ambitious projects came due during the same period. Finally, the drought of 1982-84 doused any prospects of boosting agricultural output in order to revive the economy.

With IMF and World Bank assistance, a series of adjustment and reform programs were put in place over the decade of the 1980s. These programs produced varying degrees of success. Combined, the 1988 Industrial Development Strategy, the 1990 Financial Stabilization Program, and the 1990 drafting of a three-year Economic Recovery Plan represent a new attempt at structural economic reform. For the sake of this study, the 1988-90 period is therefore defined as the "Reform Period," even though, in fact, Cote d'Ivoire has been working toward structural reform since the early 1980s.

II. Evolution and Chronology of Cote d'Ivoire's Economic Reform

1980

Modest political liberalization. Alternative candidates contested the outcome of elections and more than one candidate was allowed to stand for the 147 legislative seats.

Constitutional changes result in a new vice-presidential post which will fill the presidency in the case of a midterm vacancy.

1981

Resentment of Mauritanian traders results in violent attacks.

Recession begins due to adverse shift in the terms of trade for Cote d'Ivoire's main crops— coffee and cocoa. Debt repayments for large projects started in the 1970s now due.

Austerity measures are put in place with the assistance of the IMF and World Bank. The IMF grants an extended fund facility of SDR484 million for 1981 through 1984.

The World Bank approves a $150 million structural adjustment loan.

1982

First year of a three-year drought.

1983

An opposition party, Front Populaire Ivoirien (FPI), is founded by Laurent Gbagbo. The government hounds him out of the country. He continues to run his opposition from Paris.

The World Bank approves a $251 million structural adjustment loan.

1984

First of three debt rescheduling agreements with the London Club (the last of these was not instituted). First of five rescheduling deals with the Paris Club covering some $880 million in all.

New standby credit of SDR83 million from the IMF.

Government realigns (cuts by as much as two-thirds) salaries of parastatal workers with those of the regular civil service. Previously, parastatals were allowed to set their own pay scales.

All civil servants' pay is frozen for three years.

1985

A "screening" process is introduced to the political process after "irregularities" were noticed in the 1980 elections. The process was to weed out "militancy and immorality."

Houphouet-Boigny is elected to his sixth term in office, with 100 percent of the tally. There were no rival candidates.

At the PDCI (the ruling party) congress, the president pushes through a constitutional amendment abolishing the never-filled vice-presidential post. The head of the assembly would become interim president in the event of a midterm vacancy.

Attacks against Ghanaian immigrants because of the depressed economy.

World Bank industrial reforms begin. They include removing protectionist barriers, reducing tariffs, the elimination of import quotas, and a new investment code.

The new investment code is passed and features:

Exemption of customs duties on imported inputs and spare parts
Reduced taxation for those locating outside Abidjan
Free repatriation of earnings
Minimum-size requirements for investment assistance have been reduced
Agro-industries now pay a reduced tax rate.

Export subsidies are enacted for a limited number of manufactured goods.

New IMF standby credit of SDR66 million.

1986

A two-year standby credit of SDR100 million from the IMF is agreed upon.

The World Bank approves a $250 million structural adjustment loan.

Debt-rescheduling is completed with London and Paris Club creditors.

A $250 million road-building project gets under way with financing from several private banks, the African Development Bank and The World Bank.

The state marketing board (CAISTAB) maintains the CFAfr400/kg price for cocoa despite a lower world price and pressure from the multilateral institutions.

Cote d'Ivoire finally gives in and joins the international cocoa agreement.

The International Coffee Organization suspends an export quota as coffee prices soar.

1987

Opposition to the government increases considerably.

Export subsidies are extended to all manufactured goods.

Paris Club debt rescheduling.

Government announces a moratorium on all debt repayments.

The IMF cancels its most recent two-year standby agreement.

Coffee quota restored.

1988

Laurent Gbagbo returns home from Paris when the government seeks to make amends with its opponents.

Allassane Ouattara begins to play a leading role in the financial and economic planning affairs of the government. He is a well-respected technocrat with an IMF background.

A new standby agreement for SDR94 million and another SDR83 million in compensatory financing from the IMF collapses when the government falls behind in debt repayments to the London and Paris Clubs. The World Bank similarly suspends $550 million for sectoral loans it had in the pipeline.

A new industrial development strategy is adopted. It stresses the modernization of the industry, the promotion of export-oriented industries which process local raw materials, and the creation of new high value added manufacturing industries.

Government announces it is abandoning plans to reach cocoa production of 1 million tons per year. As the world's largest producer, it stockpiles cocoa in an effort to drive up prices. Large scale block sales are negotiated with the world's largest buyers rather than release cocoa onto the world market.

London Club debt-rescheduling.

1989

A recovery program is announced.

Another standby agreement from the IMF is reached for SDR175 million.

Paris Club agrees to a 14-year rescheduling of outstanding arrears.

World Bank unblocks its credits, approving a sectoral loan for agriculture ($150 million).

The state marketing board (CAISTAB) cuts the guaranteed price for cocoa in half.

The government abandons the policy of block selling of cocoa to large customers.

All coffee quotas are scrapped as prices have fallen precipitously.

1990

The recovery program austerity budget calls for cuts in all wages. This sparks intensive and widespread strikes and protests. The government quickly scraps the austerity budget.

In its place, a new 18-month financial stabilization program aimed at eliminating the budget deficit is announced to sway creditors. The program includes:

A 25 percent cut in government spending
Raising stamp duties
Increasing cost of resident permits
A new levy on rental income
A 5 percent levy on importers, manufacturers, and wholesalers to combat tax evasion
A 2 percent tax for the "statistical commission"
Voluntary early retirement from government service
Government reduction in spending on travel, communications, etc.
Closure of several diplomatic missions abroad.

The financial stabilization plan, once again, rules out a devaluation of the CFA, but rumors persist.

Article 7 of the 1960 constitution, which provides for the legalization of opposition political parties, is implemented under mounting domestic and international pressure. Multi-party democracy comes to Cote d'Ivoire for the first time in 30 years; 25 new parties register. Only the FPI run by Laurent Gbagbo is expected to pose any real threat to the government.

Multi-party democracy also infects trade unions. Many new unions form.

Several "incidents" during opposition political gatherings are thought to be sponsored by the government party (PDCI).

Laurent Gbagbo of the FPI announces he will run for the presidency.

A World Bank sectoral loan is approved for agriculture ($100 million).

A three-year Economic Recovery Plan is drafted by Ouattara. Its emphasis is on improving output while cutting costs. It also emphasizes privatization of a number of public enterprises.

Presidential elections return Felix Houphouet-Boigny to the presidency for the seventh consecutive five-year term. The president gives up the chairmanship of the PDCI in an effort to bolster the democracy movement.

Allassane Ouattara is named prime minister in the new government. He is the architect of the economic recovery plan. His reputation is beyond reproach. He insists upon naming his own cabinet.

III. Analysis of the Reforms

A. Timing

- **Initial reform efforts began in 1981 in response to acute external disequilibrium.** A number of internal as well as external factors contributed to the sharp downturn in what was once the African model of capitalism. Declining commodity prices, a drought, and large debt obligations left over from the 1970s combined to produce a severe balance-of-payments crisis and a recession. These conditions led to a series of IMF and World Bank stabilization and reform programs.

- **Reform resolve was strengthened starting around 1990, when it became clear that cocoa stockpiling by itself was not a panacea for the nation's economic ills.** Meanwhile, however, Cote d'Ivoire failed to maintain control over other policy levers, that might have produced incremental, if not dramatic, gains in the nation's recovery effort.

- **Greater resolve to reform the economy also coincided with the assent to power of Allassane Ouattara.** Being a highly respected and innovative technocrat, he held successively higher posts in government through the later 1980s culminating in his rise to the post of prime minister in 1990. More importantly, he was given an increasingly free hand to manage the economy precisely because the public saw him as an honest and forthright individual. Public trust in government over the 1980s had eroded to the point where any program effort outside of Ouattara's authority generated a widespread public backlash.

B. Sequencing

- **The lead reform measure for Cote d'Ivoire in 1981 was cutting public investment as a means of adjusting internal demand.** The government managed to reduce public investment from 15 to 6 percent of GDP between 1976 and 1986. Overall, the fiscal deficit fell by two-thirds, to 3 percent, by 1984, before rising again after 1987.

- **More prudent exchange rate management could have attenuated the downturn of 1987.** Cote d'Ivoire, had it not allowed the currency to appreciate as it did, may have been able to better adjust internally to the cocoa price fall.

- **A moratorium on debt repayment in the latter part of the 1980s backfired.** This radical attempt to unilaterally suspend debt payments failed because the IMF and World Bank both withdrew crucial financial support. It is possible that the incident may also have cost Cote d'Ivoire aid assistance as well.

- **Negative perceptions of the government undermined its ability to implement certain austerity measures.** Rumors of government mismanagement and corruption fueled the anti-austerity riots of early 1990. These riots forced a reformulation of adjustment policies. Prime Minister Ouattara, in contrast, enjoys a reputation for honesty and efficiency, and should have greater political capacity to sustain and deepen reform.

- **During the mid-1980s there was a mild shift in the reform effort to encourage export sectors and foreign investment.** However, there was no wholesale abandonment of the import substitution orientation.

Structural Reform Matrix (SRM)
Worksheet for Cote D'Ivoire

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		Minimal Subsidies	4	30%	1.2	40%	1.6
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		Reduced Marginal Tax Rate	2	30%	0.6	50%	1.0
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		Franchise Out State Services	2	50%	1.0	60%	1.2
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7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	60%	3.6
		Proactive Promotion	1	30%	0.3	50%	0.5
2	Information	Free Flow of Market Information	2	50%	1.0	60%	1.2
16	Enabling Environment	Private Property Rights	9	70%	6.3	70%	6.3
		Efficient Gov. Administration	2	50%	1.0	50%	1.0
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	70%	2.1	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	44.3	45.6	53.5	52.3

COTE D'IVOIRE

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP (at factor cost):	-0.1	6.3	1.7	-0.01	-7.1	15.9	3.7	-3.9	-3.2	-6.0
By sector: Agriculture	12.9	2.1	-1.4	-11.0	2.8	9.4	12.0	-0.9	--	--
Industrial Activity	8.8	10.0	-15.0	3.1	2.8	-3.8	-5.6	-5.5	--	--
Services	-10.7	7.7	11.0	5.6	-15.3	27.7	2.1	-5.2	--	--
Per Cap. GDP-Current US $	1170	1130	960	760	660	630	700	740	740	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	9.74	9.07	8.85	8.02	7.55	7.32	7.58	7.47	7.12	7.12
Purchasing Index, US=100	113.78	88.27	77.02	67.81	60.41	55.66	71.69	72.65	57.01	51.77
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	3.02	2.34	2.28	1.96	1.64	1.95	2.39	2.52	2.00	--
Exports (fob) (1980 prices)	3.14	2.94	2.77	2.47	2.98	3.46	3.54	3.62	2.75	--
Current Account	-1.83	-1.41	-1.02	-0.93	-0.08	0.06	-0.30	-0.95	-1.10	-0.86
Capital Account	1.16	0.81	0.71	0.42	0.17	-0.04	0.38	0.35	-0.21	-0.79
Changes in Reserves	0.17	0.37	0.13	0.12	-0.02	0.03	-0.02	-0.08	-0.09	-0.13
External Debt	5.80	6.61	7.82	7.80	7.89	9.79	11.22	13.61	14.12	--
Interest Payments (on foreign debt)	0.35	0.39	0.47	0.41	0.58	0.64	0.79	0.58	0.45	0.40
Export Growth %	27.1	-6.5	-5.9	-10.6	20.5	16.0	2.2	2.5	-24.3	--
Terms of Trade % Change	-15.2	-15.8	2.4	6.0	8.6	-3.4	9.1	-16.3	5.7	--

Pre-Reform Period Reform Period Estimated

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OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	14.7	6.8	7.3	5.9	4.3	1.8	7.3	0.4	6.9	--
Fiscal Deficit (-)/Surplus as a % of GDP	-10.5	-11.7	-14.0	-10.3	-2.9	-3.4	-2.5	-7.0	-13.9	-11.2
Investment Share of GDP %	28.2	25.9	23.2	20.6	10.9	12.6	11.1	13.0	14.5	--
Savings Share of GDP %	22.2	18.8	20.3	18.9	22.4	25.8	23.0	18.6	22.4	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	102.0	105.0	136.0	--	--	--	--	--	--
Government Share in Economy %[2]	17.8	14.6	13.7	13.4	11.8	8.5	9.0	13.2	--	--
Gross New Foreign Investment (US mn$)	94.6	32.8	47.5	37.5	21.7	29.2	70.7	87.5	22.2	25.4

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

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GHANA

General Assessment of Reform

- **In general, Ghana's structural economic reform efforts since the start of its economic recovery plan (ERP) have been extremely ambitious.** The key objectives of the ERP have been reducing balance-of-payments and fiscal deficits; lowering inflation through fiscal discipline and price reform; increasing foreign exchange inflows; strengthening incentives for productive activities; rehabilitating the nation's economic infrastructure and increasing the availability of essential consumer goods.

- **A unique feature of Ghana's economic reform efforts has been the explicit emphasis on infrastructure rehabilitation.** This was an important objective, given the sharp deterioration in the agricultural, mining and industrial infrastructure that had taken place since the mid-1960s and the negative effect this had on production and distribution. Infrastructure upgrading was the centerpiece of the second (economic rehabilitation) phase of the ERP and large sums of money have been invested in a wide range of vital projects since the mid-1980s.

- **Ghana's reform program was also characterized by a strong degree of decentralization at the implementation stage.** For example, while policies designed to encourage small business development and to improve infrastructure were broadly defined at the national level, details and logistics were worked out at local levels. Also, the power to levy taxes to fund these programs was granted at the local level.

- **Political continuity has helped to sustain the reform drive.** The Rawlings government, in power since 1981, has ensured Ghana's continued adherence to market-based reform. The regime's authoritarian approach has prevented urban-based state-sector industrial workers, who have lost the most under the ERP, from significantly blocking or de-railing the reform effort. At the same time, the Rawlings and the ruling PNDC have created important new civilian constituencies in the private business sector and rural sector, both of which are observed to have benefited under the government's liberalization policies.

- **The IMF and World Bank have played important roles in Ghana's economic transformation right from the beginning. Also crucial has been donor nation support to limit the social cost of**

adjustment. Ghana has made a convincing argument before the international donor community that reform and development cannot go forward without substantial assistance. Annual donor commitments by 1989 neared $1 billion.

- **The macroeconomic results of Ghana's reform measures to date have been impressive.** Beyond achieving basic economic stability, Ghana has realized significant economic recovery since the mid-1980s, with annual GDP growth estimated at 5-6 percent in the 1987-89 period. Real per capita GDP has started to recover, albeit slowly. Ghana has kept inflation down to very low levels as a result of generally prudent fiscal and monetary policies. Budget surpluses were recorded in the 1986-89 period.

- **A marked shortcoming of Ghana's program is in privatization, a process which has evolved slowly in an otherwise dynamic reform environment.** Privatization was identified early on as a critical policy goal, given the fact that the state companies (which number more than 200) account for more than half of the nation's GDP. Yet many state companies are profitable, and divestiture has been opposed by labor and unions.

I. Background to Reform

For 20 years after its independence in 1957, Ghana embraced economic policies marked by import substitution and heavy state involvement in the economy. Policy was characterized by controls on prices and distribution, intervention in financial markets, and a subsidy structure biased against the rural. Incentives to encourage those sectors of the economy accounting for the bulk of national production exports— i.e., agriculture— were sorely lacking. Production fell as the exchange rate for exported commodities (cocoa, coffee, etc.) was kept artificially high.

Policy mismanagement, natural disasters, and external shocks combined to create crisis conditions in the early 1980s. The military government of Flight Lieutenant Jerry Rawlings had few options other than to adopt an orthodox stabilization program, which took the form of the IMF and World Bank-supported economic recovery plan. A more wide-ranging and ambitious structural economic reform program evolved over the next several years and has been sustained by the Rawlings government.

II. Evolution and Chronology of Ghana's Economic Reform

1979

Successful coup led by the popular Flight Lieutenant Rawlings. Initial objective of the coup was to "clean house" and return the government to civilian hands.

After the house cleaning, national elections were held and a civilian government was elected. But the new government was divided and ineffective.

1980

First year of a two-year drought.

Producer prices for traditional commodities (cocoa, coffee), falling for over a decade due to an overvalued exchange rate, add to the severe economic downturn.

1981

Flight Lieutenant Rawlings retakes power in December because of the ineffectual civilian government. All vestiges of a democratic government are abolished.

Economic policy under the new government is highly interventionist and attempts a "bootstrap" stabilization program. This involves price controls and greater productivity through moral exhortation. The program fails.

1983

A severe economic depression is now countrywide. Full effect of drought is felt. Some parts of the country experience food shortages. The parallel market is the only working portion of the economy.

Three-phase economic recovery plan is finalized with the World Bank and IMF. Phase I is a short-term stabilization phase. Phase II is the economic rehabilitation phase. Phase III is a liberalization and growth phase.

Short-term stabilization phase begins and is characterized by a shift in relative prices to favor production and export sectors, a reduction in the government budget deficit, relief of a severe foreign exchange constraint, and efforts to control inflation.

Cedi is devalued.

Elimination of subsidies begins— prices rise.

Taxes on international trade and domestic goods and services are raised.

Minimum wage is increased.

1984

Economic rehabilitation phase begins and is characterized by an emphasis on road, transport, railway and port infrastructure to provide the general business environment, the essential raw materials and imported inputs to productive (and foreign exchange earning) sectors.

Cedi devaluation continues.

Public sector wages are raised.

1985

Foreign bank accounts permitted with tax-free interest allowed.

Many price and distribution controls eliminated.

New investment code is published. Tax, depreciation, capital, and import duty allowances are featured to induce investment.

1986

Demonstrations and strike threats by workers in response to food price increases.

Two-tier foreign exchange auction system established.

Further clarification of the 1985 investment law is established for the mining sector.

1987

Liberalization and growth phase begins and is characterized by a relaxation of trade and payments controls, price deregulation and introduction of greater competition in public enterprise operations.

The two-tier exchange rate is abolished. Private foreign exchange bureaus are allowed. Large gap between official and parallel exchange rate remains.

Interest rate deregulation begins.

Consumer goods and import restrictions are relaxed.

1988

District elections begin. Power given to districts and financially supported by federal government.

The PAMSCAD program (program of action to mitigate the social costs of adjustment) is begun creating some 40,000 jobs for those affected by parastatal downsizing, liquidation or other disruptive features of the reform program.

Privatization program begins with 32 enterprises initially put up for sale.

Interest rate deregulation continues.

Income and property tax contribution to the national budget slashed from 68.5 percent to 17.3 percent to ease burden on private consumption.

To further ease the burden on private consumption, tax thresholds are raised on a number of goods.

1989

An IMF enhanced structural adjustment facility (ESAF) is approved on the condition that the difference between the auction and bureau foreign exchange rates is eliminated.

Three-tier corporate tax system introduced: 55 percent for banking, insurance, commerce, and printing; 45 percent for manufacturing, farming, and export sectors; and 50 percent for all others.

Import licenses are abolished.

1990

A five-gallon-per-week gas ration for government vehicles is introduced to curb public spending.

To curb private demand, a 50-500 percent sales tax is levied on luxury purchases.

Foreign investors conference held with special emphasis on agro-processing.

Foreign investment offices are established overseas.

A major restructuring of the Ghana Industrial Holding Company (GIHOC) announced:

Autonomy recommended for twelve companies
Four companies to suspend production
Liquidation measures including reassigning GIHOC's shares in other companies and the repatriation of funds held in foreign accounts on behalf of GIHOC firms

Announcement of the liberalization of fuel prices:

In line with this the Ghana National Petroleum Corporation (GNPC) increases fuel prices by 50 percent in September.

Additional public sector staff cuts are announced.

Electrical companies to be exempt from duties and sales tax on imported raw materials and components.

Increases in producer prices are announced for cocoa (28 percent), coffee (11 percent), and sheanut (1.7 percent).

Enactment of the investment code (benefits to existing enterprises)

Establishes criteria whereby previously ineligible enterprises may now qualify for investment benefits and incentives.

III. Analysis of the Reforms

A. Timing

- **A severe economic crisis precipitated Ghana's embrace of structural economic reform.** The economy was poorly managed in the 1970s, when Ghana experienced large budget deficits, an overvalued exchange rate and a deteriorating infrastructure. A natural disaster— a prolonged drought—in the early 1980s compounded the problems caused by government mis-management. A third factor was a sharp fall in the nation's term of trade, which resulted from increasing petroleum prices and declining prices for Ghana's major exports, gold and cocoa.

- **The strategic shift to market-based reforms was formulated and initiated quickly.** The reasons for this are twofold: Ghana's desperate situation required rapid, decisive action. Second, the Rawlings government wielded sufficient power to push the necessary reform measures through to implementation without getting bogged down in a political debate.

- **The 1988 PAMSCAD social program was spurred at least in part by the government's awareness of the growing social cost (and potential political risk) related to adjustment.** By 1987, some 45,000 state sector jobs had been cut and the government planned another 45,000 cuts in the 1988-90 period. PAMSCAD was created with the objective of creating self-help jobs in the poorest, but most enterprising, communities.

B. Sequencing

- **The first of three main reform phases was aimed at securing stability.** Among the key measures in the initial stabilization period were a devaluation of the cedi (to strengthen the external sector), the elimination of subsidies, and increases in select taxes. The latter two were geared to close the government budget deficit. Readjusting relative prices was also very important to end the decades-long bias against the rural sector. The exchange rate adjustment and subsidy reduction efforts went a long way toward accomplishing this goal.

- **The stabilization phase was quickly followed by the "economic rehabilitation" phase, which emphasized infrastructure rebuilding.** During this period, the government sustained gains in fiscal and exchange rate policy, while undertaking large investments in roads, ports, and communications. The goal here was to remove physical obstacles to export and general economic expansion. This second phase lasted about three years and was strongly supported by external funds.

- **The third (liberalization and growth) phase included a wide range of liberalization measures.** Trade and foreign investment regulations were relaxed, thus making the economy more open and competitive. Financial market deregulation took place as well. During this time, officials also addressed distortions in the exchange rate which had developed under the currency auction system. In 1989, the IMF agreed to a structural adjustment facility for Ghana on the condition that the foreign exchange system be reformed. The public enterprise reform and divestment

effort was also scheduled to take place in this latter period, although progress has been slow.

Structural Reform Matrix (SRM)
Worksheet for Ghana

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1982		Reform Period 1983-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	70%	6.3
		Low and Uniform Tariff Barriers	6	20%	1.2	70%	4.2
		No Local Content Regulations	4	40%	1.6	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	70%	6.3
		Minimal Exchange Controls	5	30%	1.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	80%	5.6
		Minimal Preferential Interest Rates	1	20%	0.2	90%	0.9
		Equal Access to Capital	3	30%	0.9	80%	2.4
11	Prices and Wages	Limited Wage and Price Controls	7	20%	1.4	80%	5.6
		Minimal Subsidies	4	20%	0.8	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	40%	2.4	90%	5.4
		Reduced Marginal Tax Rate	2	30%	0.6	80%	1.6
		Equitable / Uniform Tax Collection	2	20%	0.4	80%	1.6
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	50%	2.5
		Franchise Out State Services	2	20%	0.4	70%	1.4
		Simulated Privatization	3	20%	0.6	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	90%	5.4
		Proactive Promotion	1	30%	0.3	90%	0.9
2	Information	Free Flow of Market Information	2	50%	1.0	70%	1.4
16	Enabling Environment	Private Property Rights	9	50%	4.5	70%	6.3
		Efficient Gov. Administration	2	10%	0.2	50%	1.0
		Legal and Accounting System	2	30%	0.6	60%	1.2
		Infrastructure	3	20%	0.6	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE UNWEIGHTED		100	26.5	27.5	71.7	71.8

GHANA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	0.0	-1.8	-7.2	0.7	2.6	5.1	5.2	4.8	6.2	--
By sector: Agriculture	2.2	-2.6	-5.4	-7.0	9.7	0.6	3.3	0.0	3.6	--
Industrial Activity	0.3	-16.0	-17.0	-11.9	8.9	17.7	7.7	11.3	10.2	--
Services	-2.3	1.5	-5.0	2.3	7.0	7.8	7.1	9.1	8.0	--
Per Cap. GDP-Current US $	400	410	380	340	370	370	390	390	400	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	3.69	3.26	3.25	3.04	2.62	2.56	2.35	2.14	1.93	1.73
Purchasing Index, US=100	90.90	79.29	91.92	103.80	116.09	84.68	98.29	96.57	83.17	96.45
BALANCE OF PAYMENTS and EXTERNAL TRADE (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	1.13	1.07	0.73	0.64	0.70	0.81	0.90	0.86	0.92	--
Exports (fob) (1980 prices)	1.26	1.25	1.21	0.64	0.65	0.81	1.20	1.27	1.40	--
Current Account	0.03	-0.42	-0.11	-0.17	-0.04	-0.13	-0.04	-0.10	-0.07	-0.10
Capital Account	-0.06	0.13	0.09	-0.01	0.07	0.15	-0.02	0.24	--	--
Changes in Reserves	0.09	-0.02	-0.02	0.25	0.01	0.03	0.02	0.39	--	--
External Debt	1.31	1.46	1.40	1.60	1.90	2.17	2.65	3.13	3.10	--
Interest Payments (on foreign debt)	0.03	0.02	0.03	0.04	0.03	0.03	0.05	0.06	0.06	0.08
Export Growth %	32.6	-0.8	-2.7	-47.5	1.6	24.9	48.1	6.0	9.8	--
Terms of Trade % Change	-25.2	-17.5	-10.3	21.7	7.6	-6.5	-3.4	-.27	-8.2	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

GHANA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	50.1	116.5	22.3	122.9	39.7	10.3	24.6	39.8	31.4	--
Fiscal Deficit (-)/Surplus as a % of GDP	-5.1	-8.2	-5.1	-2.7	-1.8	-2.2	0.1	0.5	--	--
Investment Share of GDP %	5.6	4.6	3.4	3.7	7.0	9.6	9.6	10.9	12.3	--
Savings Share of GDP %	4.9	4.0	3.7	0.6	6.6	7.6	6.3	7.9	6.4	--
Unemployment %	1.2	1.0	0.7	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	64.0	68.0	48.0	--	--	--	--	--	--
Government Share in Economy %[2]	9.8	8.7	10.0	7.3	8.7	11.4	12.2	11.1	--	--
Gross New Foreign Investment (US mn$)	15.6	16.3	16.3	2.4	2.0	5.6	4.3	4.7	5.0	15.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

KENYA

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KENYA

General Assessment of Reform

- **Kenya's structural economic reform effort evolved gradually out of an initial stabilization program. It was moderate in intensity and somewhat limited in scope but consistently sustained over the 1980s decade.** Early efforts were concentrated in fiscal reform and devaluation of the exchange rate, the latter measure to encourage export growth and halt the decline in the balance-of-payments. Officials also raised real domestic price levels and allowed real interest rates to become positive. In the mid and late 1980s, more micro-level reforms were undertaken to develop small- scale enterprises and rural development. Officials also began rationalizing and liberalizing Kenya's restrictive import regulations later in the 1980s. This latter process continues.

- **Kenya's reform effort has been pragmatic and flexible.** For example, while interest rates were liberalized in the early reform period, capital markets remained heavily regulated until much later in the process. Yet, officials have demonstrated a fairly high degree of commitment to key reform principles, even in the face of several disrupting events, including a coup attempt, regional conflicts, and droughts.

- **The government has strongly resisted pressure for political liberalization, even as it has shown a remarkable commitment to economic reform.** Kenya's one-party state survives, even as the appeal of multi-party democracy spreads across Africa. The absence of an effective organized opposition has undoubtedly enhanced the government's ability to implement often unpopular economic reforms. At the same time, however, reform has not been approached without regard for popular sentiment.

- **IMF and World Bank support for Kenyan stabilization and structural economic reform has been substantial.** Kenya's involvement with these organizations dates back to the late 1970s and continues to the present. In addition, international donor support has been key to Kenya's stability and reform progress. Annual foreign aid amounts to the equivalent of about one-third of Kenya merchandise exports.

- **Failure to attract foreign investment is one of the most widely recognized failures of Kenya's structural reform efforts.** Kenya

has suffered heavy foreign disinvestment in recent years. The most commonly cited reasons for companies leaving the country are excessive red tape and corruption. At the same time, it is generally recognized that official policy toward foreign investment is very open. The government no longer insists on participating in new ventures; nor does it place a ceiling on repatriation of earnings.

- **Agricultural reforms were insufficient.** While officials raised producer prices early in the reform period, they did not build on such measures over the following years. In fact, the World Bank refused to release a third structural adjustment loan in 1985 because the government would not reform the grain marketing system and other agricultural import controls.

- **Reform efforts during the 1980s contributed to Kenya's economic stability and generally robust growth.** While Kenya continued to run up large trade and current account deficits, it managed to avoid full-blown crises from developing. Also, although controlling spending was constantly a problem, policy-makers avoided large, chronic fiscal deficits. Kenya's economic growth, meanwhile, averaged more than 4 percent over the course of the decade.

- **Economic liberalization policies by themselves are not likely to propel Kenya into a higher stage of economic development.** Population growth will be one of the greatest impediments to long-term development. Kenya's population growth at just below 4 percent is among the highest in the world. The nation faces the daunting problem of feeding, sheltering, educating, and employing 37 million people by the year 2000.

I. Background to Reform

Upon independence in 1963, Kenya set off on a path of "African socialism." A policy of import substitution guided much of the policy decisions in the early years. This policy was accompanied by artificially low interest rates, redistribution of land, and a marked emphasis on public enterprise. The distortions and inefficiencies brought on by these policies approached crisis dimensions during the 1973 oil price increase. By the early 1970s the burden of keeping this inefficient import substitution policy on line was crushing.

By 1975, Kenya was forced to seek assistance from the international community on a much wider scale. The IMF and World Bank responded with conditional funding. The reforms recommended by the Fund and Bank, which were initially geared toward stabilization, laid the foundation for a broader economic liberalization effort, which Kenya remained committed to for the decade of the 1980s.

II. Evolution and Chronology of Kenya's Economic Reform

1975

First IMF loan; extended fund facility of SDR 67.2 million.

Kenyan shilling is pegged to the IMF's SDR.

First Sessional Paper No. 4 linked to IMF and World Bank loans.

1978

Death of President Jomo Kenyatta; he is succeeded by his Vice President, Daniel arap Moi.

1980

Kenya experiences a foreign exchange crisis resulting from an adverse movement in the international terms of trade.

March: World Bank grants Kenya its first structural adjustment loan of $55 million.

May: Publication of Sessional Paper No. 4, which included these policies:

- Tightened government expenditure
- A shift in deficit financing from the Central Bank to the commercial banks
- Upward adjustment of nominal interest rates from 5 to 6 percent
- Quantitative restrictions will be replaced by tariffs
- Export credit/guarantee scheme to encourage manufactured exports.

October: IMF standby arrangement of SDR 241.5 million.

Central Bank lifts the ceiling on remittances of dividends by foreign companies.

1981

Currency devaluations of 5 percent in February and 15 percent in September mark the beginning of the "active" exchange rate policy prescribed by the IMF and World Bank. Currency adjustments relative to the SDR are made every 2 to 3 quarters so as to maintain a steady real exchange rate.

Interest rates are raised to 10 percent.

1982

Failed coup attempt in August by members of the Kenya Air Force.

January: IMF standby arrangement of SDR 151.5 million.

World Bank second structural adjustment loan/credit; $60.9 million/SDR 62.9 million.

Major currency devaluation of 13 percent in December.

1983

Kenya reopens the border with Tanzania allowing renewed trade.

Import duties above 30 percent are reduced by an average of 15 percent.

Government sets up a task force on divestiture. Task force draws up a new State Corporation Act, intended to authorize the divestiture process.

IMF standby arrangement; SDR 175.95 million.

Investment Promotion Center is established.

1984

Country experiences a severe drought. Inflow of relief money weighs heavily on government budget.

Majority of import duties above 25 percent are cut by an average of 14 percent.

Interest rates are lowered slightly to stimulate the private sector through bank credit.

Rural Urban Credit Finance, a non-bank financial institution, collapses in December.

1985

Large conferences in Nairobi contribute to boom in the tourism industry.

IMF standby arrangement; SDR 85.2 million.

Further tariff cuts are made; 317 consumer goods are shifted to licensing schedule 1A, making them freely importable but subject to monitoring for surplus inventory.

Quotas are due for elimination on all but 12 percent of import items.

New import licensing schedules are published in July; clarifies position for importers.

Share of consumption in GDP rises for the first time in five years.

World Bank refuses to extend a third structural adjustment loan as government resists pressure for reforms in grain marketing system and import controls.

Minimum wage is increased by 20 percent.

"Quiet" devaluation of about 17 percent.

1986

Settlement of the Ugandan civil war re-establishes trade connections to Zaire, Rwanda, and Burundi, giving a boost to the economy.

Violent student demonstrations sponsored by the Mwakenya movement (seeks the overthrow of the government).

Inflation drops as oil prices collapse.

Barclays Bank issues public shares. Kenyans respond by taking a 30 percent stake.

Short-lived coffee boom; an increase in production of 21 percent and a sharp rise in world prices caused exports to expand from $280 million in 1984/85 to $524 million in 1986/87.

Sessional Paper No. 1 of 1986 sets out the government's long-term strategic plans:

Seeks expansion in manufacturing of 7.2 percent a year
Puts weight on development of the rural sector to avoid acute social problems.

1987

Kenya hosts the All-Africa games. Government expenditure is stepped up.

Country experiences a balance-of-payments difficulty.

Money supply increases by 7.9 percent.

Large increase in public sector wages.

Price controls are removed on some foods, i.e., fresh meat.

1988

Increase in some import duties, as a result of previous year's balance-of-payments problem. Duty increases confined to consumer goods.

Measures are announced to give special treatment, in the form of government credit and taxation, to informal enterprises.

Further price controls are removed.

Shares of the state owned Kenya Commercial Bank are offered to the public, the largest share issue in Kenyan history.

The real exchange rate depreciates by almost 12 percent in an orderly, managed decline.

Government adopts a World Bank-supported structural adjustment program:

Government pledges to continue flexible exchange rate system; introduce some select import liberalization and tax reform measures to boost efficiency and export growth.

Maximum bank lending rates increased from 15 to 18 percent.

Exemption of customs and sales taxes is granted on inputs (including capital) to encourage investment.

Kenyan government stops requiring state participation in all new foreign investments.

1989

The 'Monopolies, Prices and Trade Restriction Prices Act' is enacted; important antitrust legislation. Establishes a legal framework for dealing with many restrictive practices that prevented the establishment of competitive markets, reduced concentration of economic power and controlled monopolies, mergers, and takeovers of enterprises. Repeals the existing Kenya Price Control Act.

Government reduces corporate income taxes and expands tax incentives for small-scale and rural industrialization.

1989/90 budget broadens the tax base and moves back to indirect tax sources from direct sources:

Introduction of a 5 percent tax on sales of agricultural produce
17 percent value-added tax replaces sales tax.

Capital Markets Development Authority is established to develop modern capital markets.

Government publishes a new banking bill, giving the Central Bank wider supervisory powers over financial institutions.

1990

Kenya Commercial Bank (KCB) announces it will sell more shares to the public.

President Moi appoints a committee to study the problem of unemployment; will propose strategies for relief of unemployment in the short and long term.

Measures are announced to encourage export promotion:

Reduction in the rates of import duty on raw materials and intermediate goods by an average of 5 percent
Tax exemptions for firms located in export processing zones
Increase in exemption available on import duty on industrial machinery to be located in rural areas
Reduction in the maximum rate of corporation tax from 55 to 40 percent.

General rate of VAT is increased from 17 to 18 percent.

Increase in import tariffs on a number of items that have lost quota protection.

Measures to encourage the capital market:

Kenyan unit trusts are opened to foreign investors
Stamp duty is abolished on share transactions
Withholding tax on company dividends is limited to 15 percent.

Interest rates are increased:

Savings deposits: 12.5 to 13.5 percent
Short-term loans: 15.5 to 16.5 percent
Three-year loans: 18 to 19 percent.

III. Analysis of the Reforms

A. Timing

- **Economic reforms in Kenya were begun in the late 1970s and early 1980s in response to worsening debt and balance-of-payments problems.** Stabilization was the primary focus of government policy. The precipitating event was the second OPEC oil price shock which resulted in a drastic deterioration in Kenya's terms of trade and a foreign exchange crisis.

- **Foreign investment promotion efforts were stepped up around the mid-1980s — possibly in response to companies leaving the market.** Among other things, the government established the Investment Promotion Center in 1983. Apparently, however, this did not address multi-national corporate concerns centering on claims of excessive red tape and corruption.

- **Kenya's occasional failure to limit its budget deficit prompted generally effective remedial action that prevented a loss of control in a key policy area.** Each time the deficit approached 10 percent of GDP, authorities managed to bring it down to around 5 percent. This rate was still very high, however.

- **IMF pressure has occasionally forced government reform action.** In the early 1980s, for example, the Fund reportedly held up disbursement of credits committed to Kenya because it felt the country had not devalued its currency aggressively enough.

B. Sequencing

- **The lead policy reforms in Kenya were all related to stabilization and adjustment.** They included a substantial currency devaluation, major increases in domestic interest rates, and a reduction in the government budget deficit. The government was generally successful in achieving its short-term goals in all three of these areas, but less so in the case of fiscal policy.

- **Trade reform was also pursued early on, but officials took a gradualist approach.** A major change was the switch from import license to tariff protection, which continued to keep the Kenyan economy fairly protected throughout the reform period.

- **Rationalizing interest rates came early in the reform period as did other banking reforms. But wider financial and capital market reforms were delayed for several years.** Only after some stabilization in current and capital accounts were achieved, were capital markets freer to provide the seed corn for the small scale/informal and rural enterprises the government was trying to encourage.

- **Privatization of state-owned enterprises was not a prominent feature of the total reform program.** Early policy statements seemed to indicate privatization would be a key component of the structural economic reform program. In practice, however, they never were a critical part of the government's reform efforts. Despite attempts to decentralize and privatize, much of the manufacturing capacity in Kenya is in the control of state enterprises. Public enterprise deficits cause a heavy drain on the Treasury and monopolize domestic credit supplies.

- **The latter reform period is marked by increased efforts to boost small-scale enterprises and general competition.** Special programs (tax incentives/holidays, government credits, etc.) to encourage small scale, informal and/or rural enterprises were enacted. Changes in the legal environment to encourage more competition came late in the reform period as well. The law discouraged the formation of monopolies, regulated mergers, and acquisitions of companies.

Structural Reform Matrix (SRM)
Worksheet for Kenya

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1975-1979		Reform Period 1980-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	90%	8.1
		Low and Uniform Tariff Barriers	6	30%	1.8	50%	3.0
		No Local Content Regulations	4	60%	2.4	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	80%	7.2
		Minimal Exchange Controls	5	30%	1.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	80%	5.6
		Minimal Preferential Interest Rates	1	30%	0.3	70%	0.7
		Equal Access to Capital	3	30%	0.9	50%	1.5
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	70%	4.9
		Minimal Subsidies	4	30%	1.2	50%	2.0
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	60%	3.6
		Reduced Marginal Tax Rate	2	40%	0.8	90%	1.8
		Equitable / Uniform Tax Collection	2	40%	0.8	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	30%	1.5
		Franchise Out State Services	2	30%	0.6	70%	1.4
		Simulated Privatization	3	20%	0.6	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	70%	4.2
		Proactive Promotion	1	50%	0.5	70%	0.7
2	Information	Free Flow of Market Information	2	40%	0.8	70%	1.4
16	Enabling Environment	Private Property Rights	9	60%	5.4	70%	6.3
		Efficient Gov. Administration	2	20%	0.4	30%	0.6
		Legal and Accounting System	2	60%	1.2	80%	1.6
		Infrastructure	3	40%	1.2	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	35.7	35.1	64.8	66.8

KENYA

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT															
Real % Change in GDP (1980):	3.4	7.0	9.4	9.0	3.8	5.6	3.7	0.6	4.0	2.1	4.1	7.0	5.8	6.1	--
By sector: Agriculture	7.4	1.9	10.0	3.8	-0.5	1.1	5.9	10.9	1.8	-3.5	3.4	4.7	4.0	4.6	--
Industrial Activity	0.5	-0.4	12.8	10.6	7.0	5.1	4.3	-0.6	1.7	2.1	2.4	3.8	5.4	5.7	--
Services	3.2	4.1	6.1	3.4	9.7	5.4	8.2	1.9	2.9	3.4	11.1	6.6	5.0	5.3	--
Per Cap. GDP- Current US $	230	240	270	310	360	410	420	390	340	320	310	320	340	360	--
PURCHASING POWER PARITY COMPARISON															
Income Index, US=100	5.89	5.75	6.11	6.00	5.83	5.80	5.48	5.54	5.26	4.88	4.53	4.78	4.65	4.53	4.40
Purchasing Index, US=100	62.15	57.62	58.66	64.26	63.82	67.40	60.00	51.38	46.91	40.97	38.92	44.36	46.34	41.60	36.80
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)															
Imports (cif) (1980 prices)	1.88	1.67	2.08	2.45	2.02	2.59	2.00	1.63	1.47	1.61	1.58	1.97	1.84	2.24	--
Exports (fob) (1980 prices)	1.28	1.31	1.43	1.38	1.27	1.39	1.24	1.19	1.12	1.12	1.17	1.31	1.25	1.33	--
Current Account	-0.22	-0.13	0.03	-0.66	-0.50	-0.89	-0.56	-0.30	-0.05	-0.13	-0.11	-0.04	-0.49	-0.45	-0.59
Capital Account	0.18	0.21	0.24	0.44	0.57	0.52	0.25	0.15	0.15	0.19	0.12	0.22	0.46	--	--
Changes in Reserves	0.06	-0.08	-0.28	0.19	-0.18	0.20	0.27	0.19	-0.10	-0.04	0.11	-0.08	0.10	0.05	-0.06
External Debt	1.10	1.30	1.75	2.32	2.87	3.51	3.39	3.52	3.76	3.73	4.40	4.95	5.97	5.89	--
Interest Payments (on foreign debt)	0.02	0.02	0.03	0.05	0.06	0.13	0.13	0.15	0.13	0.18	0.19	0.21	0.24	0.19	0.23
Export Growth %	6.7	2.3	9.2	-3.5	-8.0	9.2	-10.6	-3.9	-6.6	0.1	4.8	12.2	-5.0	6.6	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

KENYA

Terms of Trade % Change	-9.1	18.2	19.3	-21.7	0.1	-5.8	-8.6	-2.6	4.1	10.2	-10.1	20.6	-27.2	13.3	--

KENYA

OTHER KEY INDICATORS	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	19.1	11.4	14.8	16.9	8.0	13.8	11.8	20.4	11.5	10.2	13.0	4.0	5.2	8.3	--
Fiscal Deficit (-)/Surplus as a % of GDP	-5.2	-6.5	-4.0	-4.2	-7.0	-4.9	-7.1	-8.5	-5.3	-5.2	-6.7	-4.8	-8.[illegible]	-4.6	--
Investment Share of GDP %	18.1	20.2	23.7	29.8	22.6	30.0	28.4	22.1	21.1	23.4	25.8	21.4	24.8	25.6	--
Savings Share of GDP %	13.5	20.9	27.0	20.0	16.6	18.7	19.5	18.3	20.6	22.0	24.8	21.6	19.7	22.2	--
Unemployment %	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	106.0	101.0	90.0	98.0	95.0	100.0	94.0	88.0	86.0	83.0	79.0	83.0	--	--	--
Government Share in Economy %[2]	17.4	17.5	15.5	19.5	21.5	20.5	21.9	24.4	22.4	22.5	22.4	21.8	--	--	--
Gross New Foreign Investment (US m$)	18.1	50.3	56.5	31.7	78.9	79.0	14.1	13.0	23.7	10.8	18.1	32.7	42.8	-17.2	70.2

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MADAGASCAR

Prepared for the Center for International Private Enterprise

MADAGASCAR

General Assessment of Reform

- **Madagascar's structural reform efforts in the 1980s began slowly but grew intense and ambitious after 1986.** The program has been marked by fiscal and public enterprise reform, agricultural reform, a pro-private-sector investment code, and trade liberalization.

- **In a larger framework, moving from revolutionary socialist policies to Western, market-oriented policies represented radical change for Madagascar.** Madagascar's transformation took place within a period of six short years. In Africa, only perhaps Tanzania has undergone as drastic a transformation.

- **External factors and conditions played a decisive role in the radical policy reorientation.** The Soviets were winding down their support of socialist countries worldwide. At the same time, global recession conditions created balance-of-payments pressures. Thus, in the face of dwindling Soviet support and a deteriorating external environment, the continuation of a "socialist agenda" seemed untenable.

- **Liberalization of the financial, trade and foreign investment sectors has been rather recent.** Apparently, the perceived success of neighboring Mauritius' reforms helped spur Madagascar to make the necessary moves to deepen its own reform effort. The Mauritius example was so readily imitated by Madagascar since the two countries share a similar ethnic mix and political history.

- **Structural reform efforts have begun to show tangible results for Madagascar.** Madagascar has achieved a basic level of economic stability, as evidenced by its steadily narrowing current account deficit, among other things. Moreover, there are signs that the economy is beginning to recover. Unofficially, its GDP is estimated to have expanded by 4 percent in 1989— after nearly a decade of flat or negative growth.

- **In the near term, the nation's continued dependence on primary export commodities will keep the economy vulnerable to forces beyond the government's control.** A sharp downturn in coffee

prices could seriously undermine stability. However, the government appears committed to liberalization policies that will engender important economic diversification.

- **Foreign investment reform and new export promotion measures are viewed as crucial to the government's ability to attract investment, especially in light manufacturing.** The ongoing liberalization of the domestic market will strengthen Madagascar's links with other economies in the region, including South Africa.

- **The IMF and World Bank have played important roles in Madagascar's reform efforts.** Related to this, the nation has benefited from aid and debt forgiveness provided by Western donor nations and creditors.

I. Background to Reform

In 1975, following a three-year period of political upheaval, a new government was formed by Lieutenant Commander Didier Ratsiraka. Soon after consolidating power, Ratsiraka enacted the "Charter of the Malagasy Revolution." This policy document set out the radical socialist program that would be followed for the next several years. Foreign-owned companies in banking, finance and a variety of import-export trades were nationalized. Foreign investors were barred from taking a majority stake in any sector of the economy deemed strategic. Agricultural production was neglected in favor of new industrial investments.

By the early 1980s, the socialist agenda was abandoned, as the Soviet Union, once a key donor nation, began withdrawing its support for "marginal" socialist countries worldwide. In a pragmatic move, the Ratsiraka government then sought the help of the IMF and World Bank, thus embracing an orthodox approach to economic adjustment. One of the first moves by the government under the new orientation was to withdraw its control over the agricultural sector. Tighter fiscal management and the disbanding of a number of parastatal enterprises came next.

Structural economic reform was earnestly begun in 1986. The foreign investment code was re-written twice over the next four years. The trade regime was liberalized, as were the banking and financial sectors of the economy. Debt relief and structural adjustment loans were a continuing feature throughout the later 1980s. By 1990, Madagascar had established export processing zones and was beginning to exhibit signs of economic recovery.

II. Evolution and Chronology of Madagascar's Economic Reform

1980

After years of economic decline, Madagascar's first standby arrangement with the IMF is negotiated (SDR64.5 million).

1981

IMF standby is canceled and replaced by a more demanding loan agreement.

1982

The Malagasy franc formally withdrew from the franc zone in 1973, but maintained a fixed exchange rate with the franc until 1982 when it was de-linked.

A 15 percent devaluation of the Malagasy franc is enacted, leading to SDR 73 million in new IMF credits and SDR 50 in World Bank organized aid.

1983

General elections give a landslide victory to President Ratsiraka's AREMA party.

A 10 percent devaluation of the Malagasy franc is enacted.

Governmental control over agricultural marketing is withdrawn.

Some parastatal companies are closed in an effort to manage fiscal affairs more tightly.

1984

New IMF standby credit of SDR 33 million and compensatory finance of SDR 14.4 million is arranged.

A 15 percent devaluation of the Malagasy franc is enacted.

The Paris and London Clubs reschedule debt.

1985

A fifth IMF standby agreement, for SDR 29 million, is signed.

Using his 1983 election victory, President Ratsiraka attempts to forge a single party state but fails due to the strength of seven opposition parties.

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The expansion of credit is limited to 13 percent per year as prescribed by the IMF.

1986

IMF and donor nations meet in a consultative group and pledge $630 million in fresh aid. A sixth IMF standby is agreed to in September.

Malagasy government enacts a new investment code. Foreign investors receive import duty exemptions and tax holidays.

1987

Food supply problems lead to famine in the south. Attacks on Asian traders occur in four urban centers damaging investment prospects. Students protest in response to IMF-sponsored reform program.

Currency is devalued by 40 percent.

1988

Public sector reform begins:

State regulation of the banking system loosened
Importers given access to foreign exchange
Quality certification of exports eliminated
Quantitative restrictions on imports eliminated
Tariff structure simplified.

Agricultural production and marketing reform for all major food crops, except vanilla, is complete.

Private banking is allowed for the first time since the nationalizations of 1975:

Paris Club reschedules $212 million in debt; France pledges to cancel a total of $471 million in debt.

1989

Banque Nationale de Paris becomes the first French bank to open a private local bank since the 1975 nationalizations.

President Ratsiraka is re-elected despite opposition to the pace and sequencing of the reform program.

General, rather than specific, import licenses are introduced, thus easing import controls.

The IMF grants an Enhanced Structural Adjustment Facility (Esaf).

Economy starts to come out of its slump as GDP expands by 4 percent; Madagascar meets IMF growth targets.

1990

With his position secure for seven years, President Ratsiraka returns Madagascar to full multi-party democracy. Other political liberalization measures are passed as well. Press enjoys new freedom of expression.

Export processing zones (EPZ) are created.

Foreign investment code is amended again. Substantial concessions are given to foreign private investment.

Tax incentives for small and medium-sized enterprises are passed.

III. Analysis of the Reforms

A. Timing

- **The adoption of IMF prescriptions by 1980 was prompted by a need for new "sponsorship" in the face of declining Soviet support.** While the adoption of austerity measures sparked political disturbances, the country's economic difficulties greatly restricted the government's policy parameters.

- **Structural changes were limited, at first, to the agricultural sector and to the foreign exchange rates.** Standby arrangements from the IMF were made conditional on making adjustments in these sectors. The government did not go beyond what was called for by the Fund. In fact, there was considerable delay in implementing the adjustments prescribed by the Fund.

- **A revised foreign investment code headlined a new, more substantial package of reforms agreed to by the IMF and the Ratsiraka government in 1986.** Foreign investors were to receive tax breaks and import duty exemptions. However, most of the measures would not be enacted until two years later.

- **By early 1987, austerity measures had eroded public support for the reform effort. Strikes and ethnic violence flared up.** Although these incidents were limited, the reform effort did seem to lose some steam as a result. Interestingly, it was in 1987 that the economy registered one of its best performances in a decade.

- **Political acceptance of the reform program was solid by the elections of 1989.** In fact, not one opposition party was against the program. Instead, debate centered on how far the reform should go.

- **Further adjustments to encourage exports and foreign investment were made by the end of the 1980s decade.** Authorities strengthened incentives in response to the economic success registered by neighboring Mauritius. Madagascar also sought to capitalize on the foreign investment inflows to Mauritius, which was experiencing a labor shortage.

B. Sequencing

- **Adjustment of an overvalued currency and provision of incentives to agriculture were the two lead policy reforms in Madagascar.** Authorities sought to encourage the growth of traditional export crops (vanilla, cloves, etc.) and thus boost foreign exchange earnings. The accumulation of foreign exchange reserves would facilitate debt retirement. Higher export earnings would also increase the amount of foreign exchange available for imports needed to advance other reform and economic development goals.

- **Concern for public reaction to reform proposals delayed implementation of some program aspects on more than one occasion.** This was especially true for private foreign investment, which did not occur until 1986, initially only with minor duty and tax exemptions provided.

Structural Reform Matrix (SRM)
Worksheet for Madagascar

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1985		Reform Period 1986-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	50%	4.5
		Low and Uniform Tariff Barriers	6	30%	1.8	60%	3.6
		No Local Content Regulations	4	50%	2.0	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	70%	6.3
		Minimal Exchange Controls	5	30%	1.5	40%	2.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	40%	2.8
		Minimal Preferential Interest Rates	1	30%	0.3	40%	0.4
		Equal Access to Capital	3	20%	0.6	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	50%	3.5
		Minimal Subsidies	4	40%	1.6	60%	2.4
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	10%	0.6	20%	1.2
		Reduced Marginal Tax Rate	2	40%	0.8	60%	1.2
		Equitable / Uniform Tax Collection	2	10%	0.2	20%	0.4
10	Privatization	Divest Nonstrategic SOE's	5	50%	2.5	70%	3.5
		Franchise Out State Services	2	10%	0.2	20%	0.4
		Simulated Privatization	3	10%	0.3	20%	0.6
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	80%	4.8
		Proactive Promotion	1	50%	0.5	60%	0.6
2	Information	Free Flow of Market Information	2	50%	1.0	50%	1.0
16	Enabling Environment	Private Property Rights	9	10%	0.9	70%	6.3
		Efficient Gov. Administration	2	20%	0.4	40%	0.8
		Legal and Accounting System	2	20%	0.4	50%	1.0
		Infrastructure	3	30%	0.9	40%	1.2
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/ UNWEIGHTED		100	27.4	25.6	47.4	51.4

MADAGASCAR

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GNP (1980):	-0.3	-10.8	-1.5	0.5	0.05	2.7	0.6	0.05	0.9	--
By sector: Agriculture	2.5	-4.5	4.0	2.6	3.1	1.9	6.1	-1.1	1.1	--
Industrial Activity	-2.7	-22.5	-14.3	1.4	5.1	4.4	-3.0	9.4	2.1	--
Services	1.3	-7.6	-1.1	-0.2	-0.2	1.9	-0.2	1.0	2.3	--
Per Cap. GDP-Current US $	350	330	320	300	270	240	230	210	180	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	5.16	4.55	4.67	4.53	4.13	3.92	3.83	3.64	3.46	3.28
Purchasing Index, US=100	60.80	54.54	51.51	48.10	37.99	36.06	43.44	45.88	41.16	39.59
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	0.48	0.46	0.46	0.44	0.44	0.51	0.48	0.46	0.49	--
Exports (fob) (1980 prices)	0.40	0.37	0.37	0.35	0.37	0.30	0.30	0.35	0.28	--
Current Account	-0.57	-0.41	-0.30	-0.25	-0.19	-0.18	-0.14	-0.14	-0.15	-0.13
Capital Account	0.35	0.27	0.16	-0.02	-0.01	0.03	0.02	--	--	--
Changes in Reserves	0.03	0.01	0.06	-0.01	-0.03	0.02	-0.05	-0.04	-0.09	-0.05
External Debt	1.26	1.61	1.92	2.10	2.16	2.46	3.01	3.73	3.60	--
Interest Payments (on foreign debt)	0.03	0.03	0.04	0.03	0.03	0.05	0.06	0.10	0.08	0.09
Export Growth %	-0.7	-8.7	0.2	-4.1	4.8	-17.6	-2.5	16.7	-18.6	--
Terms of Trade % Change	-15.9	-13.2	7.6	1.3	4.9	4.4	34.1	-24.1	20.0	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MADAGASCAR

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	18.2	30.5	31.8	19.3	9.9	10.6	14.5	15.0	--	--
Fiscal Deficit (-)/Surplus as a % of GDP	-10.0	-15.0	-8.8	-6.7	-4.8	-4.7	-4.0	-4.4	--	--
Investment Share of GDP %	23.5	18.1	13.4	13.2	13.6	14.0	13.7	14.9	16.3	--
Savings Share of GDP %	6.5	6.5	3.8	6.3	9.2	8.7	8.8	8.4	7.8	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	100.0	83.0	60.0	62.0	66.0	--	--	--	--
Government Share in Economy %[2]	16.6	18.9	18.6	18.6	16.7	17.1	17.1	16.3	--	--
Gross New Foreign Investment (US mn$)	--	--	--	--	--	--	--	--	--	6.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

NIGERIA

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NIGERIA

General Assessment of Reform

- **Nigeria's structural economic reform efforts, precipitated by a sharp downturn in petroleum export earnings in 1986, have been ambitious and wide-ranging.** Since the onset of reform, most price controls have been eliminated, state marketing boards have been dismantled, and the trade and foreign exchange regimes have been liberalized. Officials also have made progress reforming the financial and public enterprise sectors. To its credit, the government has sustained the reform drive despite significant levels of domestic resistance and political unrest.

- **The Babangida government made great efforts to ensure that its structural adjustment program (SAP) was seen as being developed for Nigerians by Nigerians.** Initially, officials rejected IMF loans and prescriptions, and in doing so succeeded in building strong public acceptance for "home-grown" reforms (which were then sanctioned and financed by the World Bank). Babangida's nationalistic presentation of the adjustment did seem to enhance the longevity of the program. Any externally imposed economic program might have been fiercely resisted.

- **The presidential office — and not the planning or economy ministries — took charge of initiation, implementation, and day-to-day operation of the SAP.** This direct and sustained executive involvement ensured that the changes called for by the SAP would be implemented by the large, and potentially obstructionist, bureaucracy. Furthermore, clear presidential identification with the reform program reinforced the perception that the SAP was Nigerian designed.

- **The government made several attempts during the SAP to check the public pulse.** For example, in 1985, authorities put the option of a conventional IMF stabilization agreement up to public debate. The public used this feedback channel to express their opposition to an IMF deal. This message came through clearly to the government, which then backed away from the IMF option. In a number of other ways, changes were made to the SAP in response to feedback from the public. However, as suggested by violent student riots in 1990, this sensitivity on the government's part did not guarantee universal and unconditional acceptance of essentially unpopular austerity policies.

- **Nigeria's economic crisis underlines its dependence on a strong trade surplus to maintain living standards.** Unlike other highly indebted developing countries such as Mexico and Brazil, Nigeria is acutely dependent on imports. Lacking sufficient export revenues to cover basic food and consumer imports, Nigerian living standards have fallen precipitously. The withdrawal of subsidies under the SAP has compounded the decline in living standards. Of all the world's indebted countries, Nigeria has suffered the sharpest decline in purchasing power.

- **Overall, the outcome of the SAP to date has been moderately positive.** Basic stability has been achieved in the balance of payments, and a wide variety of price distortions have been corrected. Fiscal policy has been very uneven, but officials have at least averted massive deficits and Latin American-style hyperinflation. One of the key measures of future success will be Nigeria's ability to leverage policy reform into a broad-based restructuring of its foreign debt, which remains unacceptably high. The debt is perhaps Nigeria's most serious economic obstacle to development.

- **Critical to long-term debt management and resumption of balanced growth is economic diversification.** This has not happened on any significant scale since Nigeria started down the reform path. To diversify its productive base, it is widely held that Nigeria needs foreign investment. Enticing multi-national investment will only be possible under stable and predictable political conditions. The uncertainty surrounding the 1992 transition to civilian rule is likely to deter investors from committing to new projects before then.

I. Background to Reform

A series of governments and military takeovers dominated the political agenda in the years immediately after independence. The discovery and development of the oil industry dominated the economic agenda. Substantial growth occurred in the 1960s and 1970s as did both the price and volume of oil-financed expansion projects in state-owned enterprises, and civil services. The policy at the time was to allow oil revenue to create Africa's first "great society"— whereby a majority of the population's needs would be taken care of by the state.

A civilian government elected in 1979 was widely seen as ineffectual and corrupt. This led to a new military takeover in 1983 by General Buhari and then again in 1985 by General Babangida

who retains power today. Shortly after taking power, Babangida, who carries large popular support, set the country on a course of political and economic reform. The effort was aimed at removing the rigid structures of government interference in the economy and, by 1992, returning the government to civilian rule. The steadfastness with which the Bagangida government has pursued these goals has won widespread praise from the international community.

II. Evolution and Chronology of Nigeria's Economic Reform

1978

New draft constitution is unveiled lifting the ban on political parties.

1979

Elections are held at the state and federal levels. The National Party of Nigeria (NPN) wins the largest number of seats in the Senate and House of Representatives. The presidency is won by Shehu Shagari.

1980

Strife in the new government erupts at a variety of levels. The Shagari government is widely accused of wholesale corruption.

1982

Worldwide recession and falling oil prices turn the economic miracle of 1970s on its head. GDP growth, which was 5.3 percent in 1980, falls to -8.4 percent by 1981.

1983

New elections are held at state and federal levels. They are thought to be rigged.

Senior military officers stage a successful coup. Gen. Muhammadu Buhari assumes control of the country. A "war on undiscipline" is issued to straighten out economic mismanagement. IMF structural reforms are flatly refused.

1985

A bloodless coup is staged by General Ibrahim Babangida. A full shakeup in the national government produces a relatively more balanced and representative government than previous administrations.

An "open government" policy is put to the test when a national debate over accepting an IMF loan and the reform conditions that go with it, which Babangida favored, is defeated. The Babangida government honors the public wish and rebuffs the IMF.

A coup plot is uncovered.

1986

A political bureau is established— setting a timetable for elections and return to civilian rule by October 1990. The timetable was then delayed until 1992.

World oil prices crash, precipitating major economic crisis.

The soaring popularity of Babangida allows strict IMF-like austerity to be imposed with little or no public backlash.

Nigeria embarks on a "structural adjustment program" (SAP):

Second-tier foreign exchange market established (SFEM)
The naira depreciates by 63 percent
Import licensing system abolished
Import levy abolished
Tariff cuts introduced
Petroleum and fertilizer subsidies reduced
World Bank supports the adjustment effort

Paris and London Club debt-rescheduling avoids a large bulge in debt repayments due in 1987 and 1988. The rescheduling is done on special arrangement with the IMF and creditor clubs so as to avoid public backlash.

1987

National Election Commission (NEC) is established, subsuming the political bureau, to oversee the election process. All former government officials, including Babangida himself, are barred from future elections by the NEC.

Disillusionment with the Babangida government grows as the pain of economic austerity sets in. Trade unionists and students clash with police.

The "first-tier" official exchange rate used for debt servicing is abolished. A foreign exchange market (FEM) is created.

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Interest rate controls removed.

Corporate and personal income taxes lowered.

Investment tax set at 15 percent.

Nigeria reaches agreement with the IMF on the first of three standby agreements. Initially the facility is not used for domestic political reasons.

1988

Debate on a new constitution and the inclusion of *sharia* or Islamic fundamentalist law into the constitution breaks down into violent protest.

External borrowing policy announced aimed at:

- Increasing foreign exchange earnings
- Establishing criteria for foreign borrowing
- Outlining mechanism for servicing debt
- Clarifying roles and obligations in managing debt.

Debt-for-equity swap program begun. First auction held on November 30.

Budget features a new customs and excise tariff schedule:

- Many concessions and exemptions eliminated
- Landing charge set on imports to match excises on local products.

The Central Bank of Nigeria (CBN) becomes autonomous of the government. The governor of the bank reports directly to President Babangida.

Privatization begins:

- 96 enterprises targeted for privatization
- 18 companies targeted for partial commercialization.

Industrial Development Coordination Committee (one-stop investment center) established.

Number of banned import items reduced from 74 to 15.

New legislation directs bank loans to agricultural enterprises and small and medium businesses.

Late in the year the CBN moves to a contractual monetary policy.

Copyright decree issued dramatically increasing penalties for those violating intellectual property protection.

1989

The ban on political parties is lifted.

Nigerian copyright council is established.

Foreign investment laws liberalized. Foreign investors allowed to take a larger stake in businesses from a wider array of economic sector's previously deemed "strategic."

Interbank foreign exchange market established (IFEM) to eliminate differences between government auction rates and private exchange bureau rates (at times a 60 percent difference) — all exchange rates are now unified.

Subsidy on domestic price of petroleum, utilities, and telecommunications reduced.

Import prohibition list shortened.

A second IMF standby agreement is reached.

The Central Bank of Nigeria (CBN) further contracts the money supply by calling in all public sector debts from private banks into CBN, thereby controlling about 27 percent more of the total money supply.

CBN licenses private money exchange facilities. The exchange rates used by these facilities are market determined.

Second Paris Club debt-rescheduling is completed.

The Babangida government rescinds the recognition of 13 separate political parties in the run up to the elections for a civilian government in 1992. In their place, two national parties have been created. The Social Democratic Party (SDP) stands on a platform of an active role for the government in the economy. The National Republican Convention (NRC) stands on a free-market platform. Some analysts say the outcome of the elections may be viewed as a referendum on the structural adjustment program.

Babangida government undertakes major shakeup of armed forces and council of ministers— ostensibly to improve government performance.

1990

Coup attempt by rebel officers is put down easily. Yet, incident underlines regional and religious tensions in the country.

President reiterates his intention to hand over government to civilian rule in 1992.

Budget cuts and other austerity measures spark student riots across the country. More than 50 people die.

The government responds to the rioting and deaths by approving emergency funding for SAP relief program, creating 60,000 new jobs among other measures.

The 1990 Nigerian Enterprises Promotion (NEP) decree reserves 40 activities for local ownership, but 100 percent ownership by foreign concerns in other areas is allowed. Exceptions in the restricted sectors are made for enterprises with capital greater than $2.5 million.

1991

The IMF approves a third standby arrangement of $449 million dollars.

III. Analysis of the Reforms

A. Timing

- **Falling oil prices and a worldwide recession precipitated Nigeria's structural economic reform policies.** Since the Nigerian economy is acutely dependent on oil export revenue, it was hit very hard by the 1986 crash in world oil prices. In that year, the nation's export earnings fell by nearly half. Although not a formal IMF stabilization program, the Babangida government's SAP contained the critical features needed to avert a further economic collapse.

- **Significant change came soon after the Babangida regime took power in 1985.** Babangida enjoyed the advantage of being a new and popular president, familiar to the nation by virtue of his participation in previous coups. The Babandiga SAP was also a

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logical extension to the previous Buhari government's "war on undiscipline," which was an attempt to clean up and correct the fantastic corruption and mis-management committed under the preceding government.

- **Public acceptance of a Nigerian-formed structural adjustment program (SAP) grew tremendously after the government rejected the IMF-sponsored loans and programs.** This was important for the longevity of the program. Nigeria's large and powerful bureaucracy could have torpedoed the reform program at the implementation stage had the public actively resisted it. Public acceptance of reform neutralized the potential obstructionism of the bureaucracy.

- **The SAP coincided with increased political freedoms.** Prior to the Babangida era, some political freedoms were being granted, but not on a large scale. Babangida's policy of "open government" went a significant step further in putting an IMF loan offer up to a national debate. Although the government favored accepting the loan, the public did not, and the IMF loan was rejected. A clear timetable to return the government to civilian rule aided in widening political freedoms.

- **Rapid-fire structural changes came prior to a new IMF standby arrangement.** On the political front, a National Elections Commission was established. On the economic front, exchange rate, interest rate, and tax reform came just before the first IMF standby arrangement was reached. For political reasons, the loan was not used.

- **The consolidation of 13 political parties into just two for the 1992 federal elections is likely to be seen as a referendum on the SAP.** In fact, many state elections in 1991 may be run under the same two-party system giving an even earlier indication on where the public stands five years into the SAP. The consolidation of political parties itself may influence the outcome of the public's acceptance of the SAP.

B. Sequencing

- **The "moral exhortation" of the Buhari government was a failure.** No definitive programs were put in place to discipline or give incentives to decisionmakers to change their normal mode of operation. This did, however, answer the call by the public and the international community to improve honesty and efficiency in government, as well as signaling a recognition that oil wealth

is not endless. In this sense, a path was laid with which the Babangida government could pursue more stringent reforms.

- **The trade and exchange rate regimes were the lead policy reforms in Nigeria.** The devaluation of the naira was substantial at first, leading the way toward a modest increase in non-oil exports. Quantitative restrictions on imports, in the form of licenses, could then be abolished since prices more accurately reflected world price levels. Fiscal measures were also part of the first wave of SAP reforms— a recognition that generous subsidies could no longer be absorbed by the shrinking government resource base.

- **The banking and financial sectors of the economy were soon liberalized to 'get the price of money right' and to provide some of the grease required to ensure other reforms would succeed.** Officials rightly felt that the successful privatization of state companies, the promotion of private investment, and the broader re-activation of the economy required strong and efficient capital and equity markets.

- **The most recent reform phase has involved privatization, commercialization of state companies (or "simulated privatization"), and foreign investment promotion.** The results of the first two efforts have been respectable. The government has sold off stakes in more than 19 companies, and reforms have put many companies on a sounder commercial footing. Nigeria's ability to attract foreign investment has been less successful, despite the existence of a debt-for-equity swap program and increasingly liberal foreign investment regulations.

Structural Reform Matrix (SRM)
Worksheet for Nigeria

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1985		Reform Period 1986-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	40%	3.6	70%	6.3
		Low and Uniform Tariff Barriers	6	40%	2.4	70%	4.2
		No Local Content Regulations	4	50%	2.0	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	70%	6.3
		Minimal Exchange Controls	5	20%	1.0	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	20%	1.4	60%	4.2
		Minimal Preferential Interest Rates	1	20%	0.2	80%	0.8
		Equal Access to Capital	3	30%	0.9	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	70%	4.9
		Minimal Subsidies	4	20%	0.8	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	50%	3.0
		Reduced Marginal Tax Rate	2	30%	0.6	60%	1.2
		Equitable / Uniform Tax Collection	2	30%	0.6	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	70%	3.5
		Franchise Out State Services	2	20%	0.4	60%	1.2
		Simulated Privatization	3	30%	0.9	80%	2.4
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	80%	4.8
		Proactive Promotion	1	50%	0.5	90%	0.9
2	Information	Free Flow of Market Information	2	50%	1.0	70%	1.4
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2
		Efficient Gov. Administration	2	20%	0.4	40%	0.8
		Legal and Accounting System	2	50%	1.0	70%	1.4
		Infrastructure	3	60%	1.8	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	34.3	35.1	67.4	68.3

NIGERIA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	5.3	-8.4	0.5	-4.1	-6.7	7.9	3.2	1.8	4.1	4.0
By sector: Agriculture	4.9	-16.5	3.1	0.1	-6.7	14.3	9.2	-7.7	5.5	--
Industrial Activity	-2.2	-10.1	-2.1	-14.8	-6.3	9.6	-2.8	-3.7	7.9	--
Services	5.1	6.5	0.4	1.3	-7.0	0.2	1.6	-0.4	-0.3	--
Per Cap. GDP-Current US $	1020	1090	1120	990	910	950	700	370	280	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	7.22	6.12	5.65	5.03	4.59	4.24	3.94	3.52	3.11	2.69
Purchasing Index, US=100	126.54	114.55	108.59	103.35	132.43	129.00	129.52	143.38	125.38	117.97
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	16.64	20.81	16.36	13.11	10.28	9.73	7.23	7.56	6.28	--
Exports (fob) (1980 prices)	25.97	16.23	12.22	11.31	13.16	15.32	14.69	13.26	14.78	--
Current Account	5.10	-6.22	-7.24	-4.35	0.12	2.57	0.37	-0.07	-0.19	-0.14
Capital Account	-0.76	1.44	1.66	1.37	-1.08	-3.88	-1.52	-3.13	-4.40	--
Changes in Reserves	-4.69	6.34	2.28	0.62	-0.47	-0.21	0.59	-0.08	0.51	-1.11
External Debt	8.86	12.02	12.82	18.42	18.43	19.32	23.16	30.04	30.72	--
Interest Payments (on foreign debt)	0.53	0.54	0.87	1.00	1.25	1.30	0.52	0.55	1.44	1.27
Export Growth %	-7.9	-37.5	-24.7	-7.5	16.4	16.4	-4.1	-9.8	11.5	--
Terms of Trade % Change	39.9	9.6	-7.5	-3.1	1.0	-9.5	-50.3	20.4	-25.5	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

NIGERIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	10.0	20.8	7.7	23.2	39.6	5.5	5.4	10.2	38.3	--
Fiscal Deficit (-)/Surplus as a % of GDP	-3.1	-11.7	-7.4	-9.6	-4.2	-2.5	-3.5	-8.8	--	--
Investment Share of GDP %	20.5	21.4	15.4	11.4	6.0	7.7	10.0	12.1	12.8	--
Savings Share of GDP %	29.5	18.0	9.3	8.0	7.7	10.9	7.7	17.6	15.2	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	107.0	103.0	83.0	68.0	--	--	--	--	--
Government Share in Economy %[2]	8.9	12.0	12.4	12.7	9.1	7.4	10.9	18.3	--	--
Gross New Foreign Investment (US mn$)	-739.3	546.0	433.0	344.0	200.0	478.0	167.0	603.0	377.0	2082.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

SENEGAL

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SENEGAL

General Assessment of Reform

- **Senegal's structural economic reform efforts since 1985 have been moderate in intensity.** Key goals have been reforming agriculture, increasing government efficiency, removing or reducing trade restrictions, revamping the investment code, and privatizing select state companies. Late in the reform period, the government restructured the banking sector of the economy and significantly reduced the government payroll.

- **Economic reform was preceded by political liberalization.** The new Diouf government, in an attempt to distance itself from the preceding regime, liberalized the political environment. In the process, the Diouf government gave a much greater voice to opponents of the reforms, particularly the unions. Pressure from the unions and other political groups influenced the shape, intensity, and sequence of subsequent economic reforms.

- **Serious change seemed to take place only as a result of crisis.** The drought and oil shocks of the 1970s forced the government to embrace at least the idea of structural reform. But substantial reform did not occur until the nation faced a second major drought and the IMF withdrew its support in 1984.

- **Constructing a safety net within the structural adjustment program came about, like the reforms themselves, only after political pressure forced the government's hand.** Though the government apparently weathered some strikes in 1987, by 1989 discontent over the austerity measures and fiscal constraints forced a new jobs program. Political pressure also resulted in higher tariffs on imported goods.

- **The exchange rate was not a policy tool utilized in the reform effort.** Senegal, like 14 other African countries, uses the CFA franc (Communaute Financiere Africaine) as its currency. The CFA is free of restrictions and is convertible to the French franc. This feature makes Senegal attractive to foreign investors. At the same time, however, the CFA franc, since it is pegged to the French franc, denies the Senegalese government power to adjust the exchange rate to influence trade flows. Senegal is therefore vulnerable to unfavorable

movements of the French franc or the dollar. When other major world currencies values are falling, the CFA effectively appreciates, thus making traded commodities (groundnuts, in Senegal's case) more expensive on the world market. This happened in the late 1980s as the value of the U.S. dollar fell.

- **Positive economic benefits came about in the latter portion of the reform period.** Four straight years of positive real GNP growth have been realized in the 1985-88 reform period. This contrasts with great year-to-year volatility in the pre-reform period. A decreasing inflation rate was also evident in the reform period.

- **Multilateral institutions played an important supportive role throughout Senegal's structural reform effort.** Also, the nation was a beneficiary of French and U.S. debt forgiveness programs.

I. Background to Reform

By 1980 the new president of Senegal, Abdou Diouf, was quickly establishing a tone in all government affairs which was different from his predecessor, Leopold Senghor, who was the dominant political figure for two decades. Diouf pledged to tackle corruption and mis-management in political and economic life. The agricultural marketing system was to be overhauled— raising prices to induce producers, for example. A symbolic visit to Mecca made a clean break with Senghor's Christian past. The limit in the number of political opposition parties was lifted in 1981.

The World Bank and IMF were encouraging Senegal to take bolder steps to restructure the economy as early as 1979. Among other things, they pressed for cutbacks in the bloated civil service. But reducing the government payroll proved hard to manage politically, especially during the drought years of the early 1980s. By 1984, a new drought was in its second full year. Still, the IMF was reluctant to negotiate another standby agreement if there was no movement toward reform. These two factors forced the government's hand.

A structural adjustment program of trade, agricultural, price and banking reform, and privatization, began in earnest in 1985. Some minor setbacks in the program have arisen due to new drought conditions or political unrest, but the overall reform effort has moved forward.

II. Evolution and Chronology of Senegal's Economic Reform

1978

Leopold Senghor, the dominant figure in Senegalese politics, is elected president for the fourth time since independence.

Second oil shock combined with another drought hits the economy hard.

1979

World Bank's first-ever structural adjustment loan is granted to Senegal.

An IMF standby agreement is reached.

1980

President Senghor resigns - one of the first African presidents to voluntarily leave office. He is succeeded by Abdou Diouf. Diouf liberalizes political life.

1981

Opposition political parties are legally sanctioned for the first time since the 1960s.

1983

Diouf is re-elected by a wide margin.

1984

A second full year of drought devastates the economy.

The IMF withdraws its support due to the government's reluctance to implement an adjustment program that had been recommended since the beginning of the decade.

Both the drought and withdrawal of IMF support finally push the government to seriously embrace a structural adjustment plan.

New agricultural policy is established giving significant autonomy to farmers and farmer groups. The state concentrates on price stabilization rather than direct market intervention.

Paris Club rescheduling of $310 million in commercial debt is completed after three years of negotiations.

1985

The seventh economic plan is implemented. Its goals include:

Reduced government subsidies
Increased taxation
Tighter monetary policy
Controls on public sector employment and wages.

1986

New industrial policies are announced. Goals include:

Reduced tariff barriers
Reduced government regulation of pricing and employment
Reduced corporate taxes
Liberalized foreign investment code
Establishment of industrial free zone.

Twenty-eight wholly or partly public-owned enterprises put up for total or partial privatization.

1987

Widespread discontent over austerity measures leads to student strikes and mutiny by the national police force.

Investment code revised. Key features include:

More streamlined approval requirements for new enterprises
Equal treatment for foreign and domestic enterprises
Cutback in tax and duty relief on new investments to 12 years
Free transfer of capital and profits.

World Bank grants a structural adjustment credit.

1988

Diouf's reelection again sparks serious riots nationwide. The government agrees to reduce the retail price of rice by 19 percent.

Elimination of quantitative restrictions on trade is complete.

Investment code is revamped again. New features include:

"Single Stop" investment agency to further streamline approval
Near-automatic approval for new enterprises.

An IMF standby agreement is reached. Linked to the agreement is an enhanced structural adjustment facility.

1989

Ethnic violence with resident Mauritanians relieves domestic pressure on restructuring program. Adjustment program stays intact with the exception of an emergency $50 million employment creation program to provide some 60,000-70,000 new jobs over the next three years.

High public debts tie up available investment funds forcing banking reform, including:

Credit Lyonnais being allowed to take over 95 percent of Union Senegalaise de Banque (USB)
Closure of unsound banks
More rigorous bank inspection and supervision
Liberalization of monetary and credit policies.

Import tariffs, which had been moving down steadily since 1985, raised temporarily due to fiscal pressures:

Flat import duties increase from 10 percent to 15 percent
Fiscal duties range from 0 to 98 percent
VATs levied range from 7 to 30 percent.

Further reforms ease restrictions on employment terms and conditions for investments within the free trade zone, including:

Employment restrictions eased
40 percent of output can be directed to the Senegalese market
Reduced prices for electricity and water
Provision of factory and warehousing facilities for new investors.

France and the United States announce debt-cancellation programs for the benefit of poor African nations, including Senegal.

1990

Major government reshuffle announced. Top ministerial posts are reduced by one-third at the behest of the IMF/World Bank Adjustment Program administrators. A "superministry" of finance and economics is created.

Voluntary retirement plan enacted for civil servants in an effort to reduce state payrolls by as much as 20,000.

III. Analysis of the Reforms

A. Timing

- **An economic policy lacking direction combined with several external shocks led to Senegal's first attempt at structural reform in the late 1970s.** However, this first structural adjustment program set out by the government and the World Bank, was neither ambitious nor was it pursued with sufficient vigor.

- **Crisis economic conditions catalyzed the real reform effort.** By 1984, the economy was in disastrous shape. A second year of drought coincided with the IMF withdrawing its support for the government. Together these events convinced the government to make a serious commitment to true structural economic reform. A new seven-year Structural Adjustment Program, or SAP (1985-92), was drawn up and adopted in very short order.

- **Starting in 1987, growing discontent with the harsh austerity measures led to social unrest.** The government responded by compromising some reform policies while strengthening the social safety net. For example, agricultural prices were rolled back to make staple foods cheaper. Also, some job-creation programs were initiated— but with the blessing of the IMF and World Bank.

- **Facing fiscal pressures and persistently high import volumes, the government did an about-face and raised import duties in 1989.** In fact, at this point, the government tried a variety of different approaches to soften but continue with the SAP by steering clear of politically sensitive areas. Revamping the investment code several times in order to attract more foreign investment was key among these.

- **Problematic relations with neighboring countries drew domestic attention away from the SAP, thereby giving the government some political breathing room.** The splitting of the economic union with Gambia and the expulsion of merchant Mauritanians caused a flurry of nationalistic cohesiveness. This helped the government keep the SAP in place.

B. Sequencing

- **The lead reform in the SAP was agriculture. The government moved away from direct intervention in agricultural markets and**

restricted itself to price monitoring and measures to maintain price stability. Since the bulk of economic activity and employment involved agricultural activities, this reform had a major impact. By engaging in restrained trading activities, the government hoped to maintain price stability and thus build investor confidence.

- **The bloated and inefficient state sector was ripe for reform, early in the reform process. But authorities delayed politically difficult cuts in the government payroll.** Some subsidies were cut, tax enforcement was increased, and controls on government spending and wages were put in place. But decreasing the payroll was postponed until 1990, when a program of voluntary early retirement and cash settlements was used to induce the payroll reduction. (However, many did not believe the government had the needed cash to make the program successful at the stated levels, and therefore did not accept the offer.)

- **By 1986 the SAP turned to the trade regime. Quantitative and tariff barriers began to fall, followed by a revamping of the investment code, and the privatization of a number of state owned enterprises.** Some corporate taxes were also reduced in the period to induce higher investment. Government regulation of wages and employment were relaxed as well. This made the investment climate more favorable.

- **A mid-course deviation to alleviate short-term fiscal pressure saw tariffs and VATs rise again.** Further undermining fiscal progress was a politically-induced jobs program.

- **In 1989, a liquidity crisis due to heavy debt loads forced earnest banking reform.** Foreign takeovers, branch closings, and consolidations were all features of this phase of the reform effort. Boosting both the availability of capital and the efficiency with which it moved through the economy were the government's objectives.

Structural Reform Matrix (SRM)
Worksheet for Senegal

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1984		Reform Period 1985-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	50%	3.0	70%	4.2
		No Local Content Regulations	4	30%	1.2	40%	1.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	10%	0.9	10%	0.9
		Minimal Exchange Controls	5	20%	1.0	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	20%	1.4	40%	2.8
		Minimal Preferential Interest Rates	1	20%	0.2	30%	0.3
		Equal Access to Capital	3	20%	0.6	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	80%	5.6
		Minimal Subsidies	4	20%	0.8	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	10%	0.6	20%	1.2
		Reduced Marginal Tax Rate	2	40%	0.8	60%	1.2
		Equitable / Uniform Tax Collection	2	10%	0.2	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	40%	2.0
		Franchise Out State Services	2	10%	0.2	30%	0.6
		Simulated Privatization	3	20%	0.6	30%	0.9
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	90%	5.4
		Proactive Promotion	1	50%	0.5	60%	0.6
2	Information	Free Flow of Market Information	2	50%	1.0	50%	1.0
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2
		Efficient Gov. Administration	2	10%	0.2	30%	0.6
		Legal and Accounting System	2	40%	0.8	50%	1.0
		Infrastructure	3	40%	1.2	40%	1.2
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	27.8	28.2	48.7	52.8

SENEGAL

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GNP:	-3.4	-1.9	15.0	2.1	-5.4	3.9	3.9	5.5	5.3	--
By sector: Agriculture	-18.6	-5.5	24.8	4.8	-18.1	7.9	10.2	2.6	7.8	--
Industrial Activity	-0.4	11.3	4.7	2.3	0.0	2.3	6.5	4.8	3.7	--
Services	2.4	-4.5	17.2	1.9	-1.4	3.1	1.6	4.1	4.9	--
Per Cap. GNP-Current US $	490	470	490	420	370	370	410	510	630	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	6.53	6.34	6.75	6.14	6.22	6.14	6.13	6.09	6.05	6.01
Purchasing Index, US=100	76.90	59.86	53.25	49.50	44.69	47.72	45.22	43.31	41.56	39.94
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	1.04	1.04	1.07	1.14	1.18	1.08	1.16	1.32	1.28	--
Exports (fob) (1980 prices)	0.48	0.47	0.60	0.65	0.67	0.60	0.74	0.77	0.84	--
Current Account	-0.39	-0.46	-0.27	-0.31	-0.27	-0.27	-0.27	-0.26	-0.27	-0.18
Capital Account	0.33	0.40	0.13	0.27	0.25	0.20	0.17	0.29	0.11	--
Changes in Reserves	0.06	0.05	0.03	0.01	0.01	0.04	0.02	0.05	-0.03	-0.01
External Debt	1.31	1.54	1.81	1.92	2.06	2.41	3.01	3.71	3.62	--
Interest Payments (on foreign debt)	0.06	0.04	0.03	0.04	0.05	0.04	0.09	0.12	0.12	0.12
Export Growth %	-25.1	-1.6	28.1	8.1	2.9	-10.6	24.1	3.3	10.0	--
Terms of Trade % Change	-1.1	3.1	-4.9	1.8	4.7	-4.3	-9.8	5.0	1.7	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

SENEGAL

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	8.7	5.9	17.4	11.6	11.8	13.0	6.4	-4.3	-1.8	0.4
Fiscal Deficit (-)/Surplus as a % of GDP	0.9	-3.5	-6.9	-6.3	-8.5	--	--	--	--	--
Investment Share of GDP %	15.3	16.4	15.8	16.2	15.8	13.7	14.6	15.3	14.5	--
Savings Share of GDP %	-0.4	-4.7	4.7	2.0	5.6	1.7	7.1	8.3	9.2	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	100.0	85.0	105.0	97.0	--	--	--	--	--
Government Share in Economy %[2]	23.1	22.0	21.0	20.3	24.9	--	--	--	--	--
Gross New Foreign Investment (US mn$)	14.4	34.3	28.1	-34.7	29.1	-15.8	-8.4	3.3	--	--

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

TANZANIA

Prepared for the Center for International Private Enterprise

TANZANIA

General Assessment of Reform

- **Tanzania's structural reform efforts since 1986 have been moderately ambitious.** There were four key stated objectives of the Economic Recovery Plan (ERP), which began in 1986. The first goal was to increase the volume of food and export crops. The second was to rehabilitate the country's infrastructure. The third objective was to increase capacity utilization through the appropriate allocation of scarce foreign exchange. The fourth goal was to restore balance to the budget and to the external accounts through rational fiscal, monetary, and trade policies. Efforts to date have concentrated on the first two objectives, with some success. Official attention is now turning to the third and fourth objectives.

- **Not all important sectors of the economy have been affected greatly by the reforms.** Most notably, Tanzania's vast public enterprise system has yet to undergo substantial reform. The trade regime has far to go before being fully liberalized, and only recently has the positive potential role of foreign investment been recognized.

- **The ERP was broader and deeper than the reform efforts preceding it.** The Economic Survival Plan (1980) lacked comprehensiveness. The Structural Adjustment Plan (1982) was a broader approach but this too failed to correct underlying distortions and bring about recovery. The ERP of 1986 took these lessons into account.

- **The implementation strategy for the ERP contained five general elements.** The first was to encourage farmers with higher prices, while devaluing the Tanzanian shilling to boost exports. The second was to make real interest rates positive. The third was to negotiate debt relief and secure new aid inflows, in order to avert a foreign exchange crunch, as well as to free up domestic resources. The fourth was to reduce recurrent costs by eliminating subsidies and declaring a public sector hiring freeze. The last was to invest in rehabilitating the infrastructure so that inputs and finished products can reach their destinations in an efficient and timely manner.

- **The changing of the political guard in Tanzania helped move the reform effort forward.** In the early 1980s, under the leadership of socialist Julius Nyerere (who held power from 1962 to 1985),

Tanzania stopped short of committing itself to a full-scale economic reform effort containing the IMF's seal of approval. However, a year after assuming the presidency in 1985, his successor, Ali Hassan Mwinyi, managed to put together an adjustment package that qualified for Fund (and World Bank) support. In 1990, Nyerere's passing of the leadership of the nation's sole political party (the CCM) to Mwinyi consolidated Mwinyi's power. With the dual title of president and CCM party head, Mwinyi was free to pursue the next phase of structural economic reform, now known as ERP II.

- **Tanzania has realized some tangible economic gains from its reform efforts.** The nation has realized real yearly GDP growth of 3 percent on average since the first ERP (1986-89) and, while inflation has remained stubbornly high, the fiscal deficit has fallen significantly. While investment as a share of GDP has recovered, the government share of the economy has actually grown during the reform years. Thus the outlook depends on containing these problem areas. Substantial reform in the public enterprise sector is needed, as are further efforts to liberalize the financial sector.

- **IMF and World Bank support has played an important role in Tanzania's structural reform efforts.** The funding itself was obviously important. In addition, as in many other country case studies, IMF sanctioning of adjustment programs facilitated debt-restructurings with other creditors. It is noteworthy that Tanzania's previous reform effort (the 1982 Structural Adjustment Plan) was launched without IMF backing. Tanzania was also one of the first beneficiaries of the World Bank's special Africa facility.

- **Foreign aid has also been a critical element in Tanzania's reform progress.** Donor contributions have financed development projects as well as provided balance-of-payments support. A close reading of Tanzania's external accounts shows that net official transfers roughly doubled after 1986— a period roughly coinciding with the country's structural reform period.

I. Background to Reform

A path of "socialism and self-reliance" was set in motion in 1967 by President Julius Nyerere after five years of independence from the U.K. The policy statement, known as the Arusha Declaration, set out to extend the state's role into all areas of the economy. The banking and insurance sectors were nationalized

and large private trading companies were taken over. The government took a major shareholding in the industrial sector. Large agricultural estates were nationalized as well. The government introduced the *ujamaa* or villagization concept, whereby farmers were relocated into agricultural cooperatives or communal farms.

By the 1980s flaws became apparent in Tanzania's development strategy. The *ujamaa* concept proved neither efficient nor popular. State-owned enterprises operated at a loss. The exchange rate was woefully overvalued. International prices for export commodities declined. This led to a chronic foreign exchange constraint. As foreign exchange earnings declined, imported inputs were put off—and exports declined even further. A second oil shock, the financial burden of the war with Uganda, the breakup of the East African Community, and the disruptive costs of the ujamaa concept conspired to force a search for better economic policies.

Several half-attempts at economic reforms did little to improve the situation. By 1986, the government was forced to embrace the full set of IMF recommendations in the form of an Economic Recovery Plan (ERP).

II. Evolution and Chronology of Tanzania's Economic Reform

1977

The main political party of Tanzania, the Tanganyika African National Union (TANU) merges with Zanzibar's Afro Shirazi Party to form a new national party called Chama Cha Mapinduzi (CCM). There is little, if any, effective opposition.

New constitution cements the CCM's position as the sole policy-maker in Tanzania.

Breakup of the East African Community (EAC).

1978

Uganda, under Idi Amin, invades Tanzania. Tanzania responds by sending 20,000 troops into the area.

1979

By mid-April Tanzania has control of most of Uganda and has ousted Idi Amin.

The Tanzanian shilling is delinked from the SDR. An overvalued currency results.

Second oil price shock hits Tanzania hard.

1980

IMF breaks off a standby loan when Tanzania fails to implement agreed-upon conditions (exchange rate devaluation, agricultural price increases, public expenditure and money supply curtailment).

The government launches an "Economic Survival Plan." The plan is not very specific.

1981

World-wide recession adversely affects major export crop prices.

The costs of the Uganda war, several previous droughts, and the disruptive nature of the *ujamaa* villagization program become apparent.

1982

A more comprehensive Structural Adjustment Plan (SAP) replaces the Economic Survival Plan. The plan seeks to restore financial and economic stability, stimulate agricultural development, improve efficiency while protecting the provision of the most basic social services and incomes of vulnerable social groups. The effort is insufficient to produce any major recovery.

1983

Coup plot by nine junior army officers is discovered.

Import controls strengthened after the record deficit of 1980.

1984

Aboud Jumbe, president of Zanzibar, resigns after separatists sentiment rises. Ali Hassan Mwinyi takes the Zanzibarian presidency and institutes a series of political and economic reforms that quell the unrest.

Large agricultural price increases give new incentives to farmers. These changes go a long way toward IMF conditions for financial assistance.

Net inflow of aid stands at $97 million.

Good rains give a boost to agricultural output.

Licenses are required for importing. An official list controls imported items. The list is greatly expanded to cover a wide range of capital and consumer goods.

Introduction of the development levy (a poll tax) that every citizen is required to pay. This levy was introduced to supplement falling sales tax revenues.

1985

Dr. Julius Nyerere resigns as president of Tanzania. Elections are held. Nyerere is succeeded by Ali Hassan Mwinyi. Dr. Nyerere remains the head of the CCM. A new Zanzibarian president is elected—Idris Abdul Wakil.

Coup plotters from 1983 are given life sentences.

Tanzania joins the Preferential Trade Area (PTA) of East and South Africa.

The economy turns down again— Tanzania begins negotiating with the IMF for assistance.

1986

An agreement with the IMF is reached for an 18-month standby worth $77.5 million under a three-year Economic Recovery Plan (ERP) replacing the SAP:

Currency is relinked to the SDR and devalued, but the black market remains
Agricultural prices are raised to encourage farmers
Interest rate increases to curb and rationalize expansion of credit
Debt rescheduling of $1.2 billion by the Paris Club
Quantitative trade restrictions to be replaced by tariffs
Improved tax collections
Public sector hiring freeze
Subsidies to parastatals are eliminated
Parastatal reduction and efficiency requirements
Public Investment Program launched to improve roads and railways.

The unavailability of consumer goods and agricultural inputs frustrates farmers. Tanzania output needs a high degree of imported inputs but foreign exchange earnings are low, due to deteriorating prices and low export goods output. Foreign aid is needed.

World Bank steps in to alleviate the foreign exchange constraint. $96 million is contributed to the ERP along with other sectoral loans.

1987

The IMF agrees to a three-year Structural Adjustment Facility (SAF) worth $28.3 million.

1988

Social unrest rises in Zanzibar over the one-party rule.

Interest rates are raised to positive real levels. Commodity prices de-controlled with only 12 basic needs goods remaining on the control-led list.

Further debt-rescheduling of $499 million by the Paris Club.

Open general license (OGL) system is introduced. Importers are now able to import up to $1 million worth of goods from a list of 40 items.

The Industrial Rehabilitation and Trade Adjustment Credit (IRTAC) is approved, simplifying the tariff rate schedule and reducing the number of exemptions.

1989

Net inflow of aid, rising steadily since 1984, reaches $470 million.

1990

Dr. Julius Nyerere resigns as the head of the CCM. Mr. Mwinyi takes over as the head of the CCM.

Parliament is dissolved in preparation for elections. There is a choice of candidates but all must be approved by the National Executive Committee (NEC) of the CCM.

Mr. Mwinyi wins re-election as the candidate for the CCM on October 28. Dr. Salmin Amour, a centrist who appeals to many groups, wins the presidency of Zanzibar after the incumbent Wakil declines to run.

Multi-party debate gains the acceptance of the CCM in principle. Most observers believe no effective opposition parties will soon emerge.

A cabinet shuffle endorses the ERP. Crackdown on corruption.

A cabinet shuffle endorses the ERP. Crackdown on corruption.

Twenty-four percent devaluation of the shilling allows Tanzania to draw the final *tranche* of the IMF three-year SAF agreed to in 1987.

Reduction in trade paperwork announced.

The 1990/91 Development Plan emphasizes infrastructure — roads, schools, hospitals.

New investment code is passed. Tax and import duty concessions, new provisions for repatriation of earnings and the proceeds of disinvestment are featured. Tanzania also joins the two World Bank agencies — the International Centre for the Settlement of Investment Disputes, and the Multilateral Investment Guarantee Agency (MIGA).

Government sets up Investment Promotion Center to streamline applications procedures.

$200 million loan from the International Development Association (soft arm of the World Bank) for agricultural marketing reform. The program includes:

Liquidation of unprofitable state farms
Abolition of the cereals marketing parastatal, the National Milling Corporation (NMC), and a reduced role for the Coffee Marketing Board, the Cotton Marketing Board, and the Cashew Marketing Board.

The Economic and Social Action Programme (or ERP II) is announced:

Contains same goals as before with additional facilities to alleviate the social costs of adjustments.

Presidential Commission report on the banking sector is released. It recommends the breakup of the National Bank and National Insurance Company. Private and foreign investors would be allowed to play a role. The recommendations are in line with IMF and World Bank recommendations.

A new agreement with the IMF has yet to be announced. Sticking points include the closing of many loss-making parastatals.

III. Analysis of the Reforms

A. Timing

- **The ERP went forward only when the government recognized that the budgetary and external payments crises of the early 1980s were not a temporary condition.** The costs of the war with Uganda, declining commodity prices, an oil price shock and the breakup of the East African Community combined to exert enormous pressure on the Tanzanian economy. Neither the 1980 nor 1982 stabilization efforts were comprehensive enough; nor were they implemented effectively. Both plans stressed boosting output and limiting luxurious consumption. But neither attacked underlying distortions in, for example, prices and the exchange rate. Nor did they address the problems of fiscal imbalances. In contrast, the combination of production incentives and strong fiscal controls under the ERP yielded modest recovery and stability.

- **Substantial change under the ERP came about only after Nyerere had relinquished the presidency.** While Tanzania had begun serious discussions with the Fund in the latter part of Nyerere's rule, a pact was not formally signed and the ERP was not launched until Mwinyi was in power.

- **A shortage of foreign exchange both precipitated the reform drive and then frustrated the Economic Recovery Plan.** An acute lack of hard currency limited Tanzania's ability to import vital inputs and thus reverse the downward cycle of declining export earnings. However, official aid helped bridge Tanzania through this acute crisis period.

- **The stage is now set for the next reform phase, which will involve more far-reaching structural changes, now that Nyerere has relinquished control of the CCM.** Even after he relinquished the presidency, Nyerere still held considerable sway in policy matters as head of the CCM. With Nyerere's full retirement from politics, Mwinyi would appear to enjoy a freer hand to pursue ERP II.

B. Sequencing

- **Restoring the incentive system for agriculture was, out of necessity, the lead policy reform.** After many years of artificially low producer prices and an overvalued exchange rate, farmers were economically desperate and demoralized.

- **The rationalization of credit was also a necessary lead policy reform.** Setting a realistic price for credit channeled scarce funds to the most productive activities. Agriculture is among these productive activities. The availability of credit was necessary to support and expand agricultural output.

- **Tanzania's crumbling transportation infrastructure was targeted for attention not long into the reform period.** Railways and roads had been neglected for many years. Farmers could not move their goods to market or to the port for export in an efficient or timely manner. There was a great deal of waste. A World Bank sectoral loan to upgrade the transportation infrastructure has begun to alleviate this constraint.

- **Debt-rescheduling was also a prominent feature used to free resources for the reform effort.** Nearly $1.75 billion in debt rescheduling was complete within the first two years of the ERP's launch. Terms were softer and payback periods were longer, allowing a significant freeing up of financial resources to aid the ERP.

- **Meanwhile, a serious effort at reducing recurrent costs and improving tax collection was under way.** A public sector hiring freeze was among the most visible of these efforts. Elimination of subsidies to many parastatals also played a large role, as did improved tax collections. Together these efforts helped reduce the public sector deficit.

- **Reform of the trade regime and public enterprises has come to the forefront of the reform effort most recently,** though in both cases the level of effort has been moderate at best. For trade, quantitative restrictions have been converted to tariffs, and the open licensing system has been instituted along with a simplified tariff schedule. But licensing still exists, as does a restrictive import control list. Public enterprise reform has involved the removal of subsidies and the abolition of some agricultural marketing boards and a reduced role for others. But a clear policy framework for privatizing or simulated privatization of public enterprises is lacking.

- **Liberalizing trade was attempted late in the reform period and with a great deal of caution.** Given the foreign exchange shortage, liberalization of trade had to proceed slowly and cautiously.

- **Active encouragement of foreign investors has only recently become a visible part of the reform effort.** Concessions to lure

investors are included in the 1990 investment code. Tanzania has also joined two international agencies to settle disputes and guarantee investments. An Investment Promotion Center has also been established to streamline the bureaucratic process for new investors.

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Structural Reform Matrix (SRM)
Worksheet for Tanzania

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1982		Reform Period 1983-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	60%	5.4
		Low and Uniform Tariff Barriers	6	40%	2.4	50%	3.0
		No Local Content Regulations	4	40%	1.6	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	70%	6.3
		Minimal Exchange Controls	5	30%	1.5	50%	2.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	20%	1.4	70%	4.9
		Minimal Preferential Interest Rates	1	30%	0.3	50%	0.5
		Equal Access to Capital	3	30%	0.9	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	20%	1.4	70%	4.9
		Minimal Subsidies	4	20%	0.8	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	40%	2.4	70%	4.2
		Reduced Marginal Tax Rate	2	50%	1.0	60%	1.2
		Equitable / Uniform Tax Collection	2	30%	0.6	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	30%	1.5
		Franchise Out State Services	2	20%	0.4	40%	0.8
		Simulated Privatization	3	20%	0.6	60%	1.8
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	50%	3.0
		Proactive Promotion	1	30%	0.3	70%	0.7
2	Information	Free Flow of Market Information	2	60%	1.2	60%	1.2
16	Enabling Environment	Private Property Rights	9	40%	3.6	60%	5.4
		Efficient Gov. Administration	2	40%	0.8	60%	1.2
		Legal and Accounting System	2	60%	1.2	70%	1.4
		Infrastructure	3	30%	0.9	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	33.0	31.8	59.1	59.8

TANZANIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	0.8	-1.1	1.3	7.4	2.5	-0.2	0.4	3.9	4.1	--
By sector: Agriculture	3.9	1.0	1.3	2.9	4.0	6.0	5.7	4.4	4.5	--
Industrial Activity	-0.3	-7.7	-0.9	-15.8	6.3	-3.9	0.6	4.0	4.4	--
Services	2.4	1.1	0.5	-2.3	1.8	1.4	0.8	3.2	3.6	--
Per Cap. GDP-Current US $	280	300	320	310	290	300	270	210	160	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	3.10	2.93	2.90	2.82	2.94	3.19	2.85	2.81	2.77	2.74
Purchasing Index, US=100	92.85	93.17	84.82	77.84	77.85	75.09	82.93	90.25	91.14	85.08
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	1.23	1.13	1.17	0.85	0.92	1.13	1.14	1.17	1.23	--
Exports (fob) (1980 prices)	0.54	0.64	0.48	0.44	0.38	0.31	0.36	0.39	0.42	--
Current Account	-0.43	-0.17	-0.38	-0.31	-0.36	-0.38	-0.32	-0.27	-0.38	-0.15
Capital Account	0.08	0.09	0.34	-0.08	-0.05	-0.33	0.91	-0.03	0.12	0.15
Changes in Reserves	0.07	-0.02	-0.01	-0.05	-0.04	0.01	-0.03	0.07	-0.02	0.01
External Debt	2.57	2.69	2.98	3.38	3.43	3.87	4.20	4.83	4.73	--
Interest Payments (on foreign debt)	0.04	0.03	0.03	0.03	0.03	0.02	0.03	0.04	0.04	0.07
Export Growth %	2.3	19.3	-24.8	-8.0	-13.7	-19.2	18.0	8.0	7.2	--
Terms of Trade % Change	-12.9	-15.0	3.8	3.1	5.7	-5.9	14.5	-13.8	5.6	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

TANZANIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	30.3	25.6	28.9	27.1	35.3	34.1	32.4	29.9	31.2	--
Fiscal Deficit (-)/Surplus as a % of GDP	-8.4	-6.7	-11.5	-8.0	-6.1	-4.4	-4.5	-3.3	-0.3	--
Investment Share of GDP %	23.0	20.6	21.0	13.6	15.3	15.7	19.5	22.8	21.2	--
Savings Share of GDP %	9.8	12.1	13.6	8.4	7.2	7.4	5.5	0.0	-4.8	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	83.0	69.0	61.0	55.0	51.0	45.0	--	--	--
Government Share in Economy %[2]	33.2	30.2	30.0	27.0	23.0	23.7	20.2	23.0	25.7	--
Gross New Foreign Investment (US mn$)	--	--	--	--	--	--	--	--	--	--

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

ZAMBIA

Prepared for the Center for International Private Enterprise

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ZAMBIA

General Assessment of Reform

- **In the 1980s, Zambia went through an extremely turbulent period marked by both orthodox and home-grown attempts at economic adjustment. It was not until the end of the decade that the nation had begun to move toward a deep, comprehensive approach to structural economic reform.** In 1983, an IMF-backed plan was erected to diversify the economy toward exports and move away from insular import-substitution policies. The adjustment program lacked political support right from the start, and the austerity measures contained within it contributed to the unpopularity of the government of President Kenneth Kaunda. In response to violent riots in 1986, President Kaunda broke with the Fund and launched an alternative program.

- **The "self-help" effort failed.** In 1989, Zambia rejoined the IMF fold, once again embracing an orthodox set of economic policies designed to correct underlying distortions in the economy. However, this time around, Zambian officials took precautions to ensure that its latest embrace of orthodoxy was perceived as "home grown," not externally imposed. This was a critical political component absent from earlier IMF agreements.

- **Some analysts have criticized the timing of Zambia's liberalization measures in the 1985-86 period.** Specifically, it has been observed that the liberalization of the credit and foreign exchange markets took place amid a financial crisis and before authorities had gained control over the federal budget deficit. Also, it has been noted that Zambia introduced the auction mechanism for allocating foreign exchange without adequate reserves and secure access to external funding. In short, the argument goes, Zambia's external situation was too unstable to support a drastic foreign exchange liberalization program. Some observers of Zambia's adjustment experience have questioned whether the government had sufficient technical expertise to engineer this complex adjustment process.

- **The political obstacles to reform facing the Kaunda government in 1983 were considerable.** Powerful stakeholders such as copper miners, farmers, and the urban middle class had benefited under the prevailing policies. They therefore resisted the threat that reform posed to the status quo. Also, the ruling UNIP party was itself divided on the subject of economic

liberalization. Finally, the Zambian bureaucracy resisted efforts to control the size and influence of the government sector. This extreme lack of consensus on economic policy characterized all of Kaunda's reform initiatives. The result was a lack of complete commitment to reform, as well as an ad hoc style of policy implementation.

- **Zambia's experience underlines the tremendous obstacles to "go it alone" adjustment efforts.** In May 1987, Zambia became the first African nation to break with the IMF, which President Kaunda accused of insensitivity to the social and political costs of austerity policies. Kaunda's "self-help" adjustment effort was unsuccessful and short-lived, with a number of management flaws observed in key components of the program. (It is noteworthy that authorities did not reject all IMF prescriptions; in fact, market-based agricultural pricing policies were retained.) Ultimately, the effort failed to arrest inflation and stem the decline in living standards. In 1989, Zambia began implementing austerity policies favored by the IMF and by 1990 a more formal arrangement was in place. However, the new deal with the IMF and World Bank was launched quietly, with the government insisting that the new, generally orthodox policy direction was internally driven and not externally imposed.

- **The "self-help" period coincided with an improvement in external factors driving the nation's economic health. Yet, the policies in place were not complementary.** The year 1988 saw good rains and a bumper agricultural crop. In addition, world copper prices rose significantly, pushing up the nation's terms of trade by some 35 percent in 1988. These positive events resulted in a one-year growth spurt. But sustained balanced growth did not follow. Inflation was aggravated. Shortages and infrastructure bottlenecks grew widespread, contributing to a sharp drop in copper output at a most inopportune time.

- **A consistent priority running through Zambia's various adjustment attempts was developing the agricultural sector.** The commodity price crisis of the 1970s underlined the nation's gross over-reliance on copper export earnings. More than perhaps any other African country, Zambia has tremendous untapped agricultural potential. The deficiencies of prevailing agricultural policies were clearly understood. Thus, starting in the early 1980s, officials attempted to reform the pricing mechanisms, improve the marketing infrastructure, and boost producer access to key farm inputs. The agricultural emphasis survived the policy change in 1987 to "self-help." Ultimately,

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however, the agricultural reform effort was seriously undermined by technical and administrative mistakes, as well as by broader environmental problems related to an acute foreign exchange shortage and poor policy leadership.

- **Efforts to stem official corruption have been part of Zambia's structural reform efforts since the December 1986 riots.** The riots led to a general crackdown on corruption and a strengthened Anti-Corruption Commission. While no politicians have been charged under the new guidelines, some senior bureaucrats have been investigated. Also, in 1989, the Central Bank governor appeared in court to face charges of corruption and mis-conduct. To restore international credibility, the government then took the extraordinary step of appointing a Canadian national to run the Central Bank.

- **The success of Zambia's reform efforts is entirely dependent on successful debt reschedulings (with concessional terms) and significant aid inflows.** According to one estimate, Zambia will need an estimated $600 million a year in concessional assistance through 1993 to keep its reform program on track.

I. Background to Reform

On the strength of copper exports, Zambia achieved one of the highest standards of living in Africa in the years prior to and after independence in 1964. The early 1970s commodity price boom fueled the growth of a statist development strategy based heavily on import substitution industrialization (at the expense of agriculture) and high levels of domestic consumption (at the expense of fiscal discipline, and domestic savings and investment). In 1975, world copper prices collapsed. Zambia failed to adjust, however, to this drastic change in its terms of trade. In effect, for seven years after the downturn in copper prices, Zambian policymakers continued to manage the economy as if nothing had happened.

By the early 1980s, profound economic imbalances and distortions forced the government to face reality. In 1983, an IMF-backed program was erected to stabilize the economy and to bring about longer-term structural change. In terms of adjustment, little progress was registered for the first two years of the IMF program. Real incomes continued falling and distortions in the economy remained widespread. In 1985, officials liberalized the foreign exchange system and allowed the currency (the kwacha) to undergo a substantial devaluation. Also, prices were decontrolled

and the subsidy on maize consumption was withdrawn. A violent public reaction followed, leading to the government's decision in 1987 to break off relations with the IMF and follow an independent reform path. In 1989, Zambia quietly resumed relations with the Fund and began a new round of adjustment and structural reform measures.

II. Evolution and Chronology of Zambia's Economic Reform

1975

World copper prices plunge. Zambia's export earnings, dominated by copper, drop precipitously.

1976

National state of emergency is declared by President Kaunda in response to the popular discontent over the deteriorating economic and social conditions. Trade, especially in copper, is disrupted by the civil wars in Angola and Rhodesia (now Zimbabwe).

The national currency, the kwacha, is de-linked from the dollar and devalued; parity then tied to the SDR.

1977

The Industrial Development Act is enacted; investment incentives are biased toward urban based industry.

1978

General elections are held. Some displeasure is shown with the government by not re-electing four cabinet ministers. But President Kaunda is returned to office handily.

Falling copper prices continue to strain the economy even though rail and road transport links have been re-established.

1980

Opposition to worsening economic conditions culminates in a coup attempt. A major reshuffle of the cabinet fails to quell the unrest.

Large pay increases for the public sector. Large increases in prices for agricultural producers. Large increases in the price of maize. (Agricultural producer prices for maize increase steadily every year leading up to the 1986 anti-austerity riots.)

Operation Food Production is introduced. It is a ten-year program to correct past policies that discouraged farmers. Goals are to boost food and export crops and establish large-scale estate farming to diversify away from copper mining.

1981

Wave of strikes. Many opposition and trade union leaders are detained.

1982

New austerity measures are introduced.

Incentives for agriculture are enacted. They include:

Two-year tax write-off
Exemption from customs duty on agricultural equipment
Foreign exchange bonuses for agricultural output exceeding a set limit
Reduction in farm income tax.

1983

Additional austerity measures introduced.

Wage increases are limited to 10 percent a year. Unions threaten to strike.

IMF Economic Recovery Program (ERP) begins.

A 50 percent foreign exchange retention incentive for non-traditional exporters is established. (Measure is aimed primarily at agriculture).

First year of a two-year drought (the impact on agriculture is light).

The kwacha is tied to a trade-weighted basket of currencies. Devaluations over the next two years drop the value of the kwacha relative to the dollar by 40 percent. Still the parallel market values the currency by a third less than this.

1984

Free collective bargaining for unions is restored.

Paris Club reschedules $140 million plus $50 million in arrears.

1985

Grey Zulu is restored as the Secretary General of Zambia's dominant political party UNIP. He is an advocate of strong central government control of the economy.

A weekly foreign exchange auction is introduced as part of the ERP:

Exchange rate falls by 56 percent in initial trading
London Club reschedules $70 million in debt
Trade tariffs shift from an FOB to CIF basis.

1986

Elimination of subsidies for maize under the austerity budget cause massive protests and riots. Government is stunned by the large number of fatalities (15). It immediately restores the maize subsidy blaming the IMF for moving too fast. Evidence suggests the riots were against the ruling UNIP party as much as the IMF.

Major government reshuffle sacks two of the architects of the Economic Recovery Program.

The Investment Act of 1986 stresses all sectors of the economy, not just manufacturing. Tax holidays on dividends, incentives to hire and train locally, duty drawbacks, reduced and exempted income taxes are emphasized for investors.

New commitments from donors tally up to $400 million.

Paris Club reschedules an additional $622 million.

1987

Social unrest continues over the austerity caused by the ERP. Strikes, protests, and open political opposition to government are common.

President Kaunda accuses unnamed businessmen of conspiring with South Africa to incite a coup.

President Kaunda is named president of the Organization of African Unity (OAU).

The pressure to change economic policy results in President Kaunda's decision to suspend the foreign exchange auction:

Replacement system is devised, offering two foreign exchange tiers
Auction is later resumed, but currency comes under massive pressure
Auction is suspended again.

On May 1 President Kaunda announces a break with the IMF and suspension of the Economic Recovery Program. In its place is a Self-Help Economic Recovery Program, also called the Interim National Development Plan (INDP).

The INDP sets vague targets and policies:

Control of inflation
A fixed and re-valued exchange rate
A 10 percent ceiling on debt repayment
A reintroduction of price controls.

The INDP does not reverse the IMF program's policies of improved agricultural producer prices or the restructuring of the parastatal operations to improve profitability.

Commercial credit inflows dry up following the unilateral imposition of a debt repayment ceiling. Donor support falls as well.

Copper prices begin to rebound somewhat.

1988

Despite political opposition President Kaunda wins re-election again. But four ministers lose their seats.

With the elections seen as a confidence vote, the government institutes a number of wide-ranging economic policy changes in response to the INDP's shortcomings:

Two devaluations of the currency
Reduction of the maize subsidy (1989)
Removal of price controls
Increase in interest rates
Reduction of budget deficit to 5 percent of GDP (target).

Public reaction is less harsh then expected with some strikes and protests. The government acts forcefully to quell the unrest.

1989

Francis Nkoma is the first government official ever brought up on corruption charges since the passage of the 1972 leadership code forbidding the amassing of personal fortunes by government officials.

The continuing strong measures by the government and the occasional visit by IMF teams indicate a rapprochement is near.

The Fourth National Development Plan (FNDP 1989-93) is announced. Emphasis is given to expanding non-traditional exports, especially agriculture, in an effort to diversify away from reliance on copper.

The IMF approves the government policy framework paper (PFP) which outlines a three-year interim Economic Recovery Program. The IMF and World Bank agree to support the program and work behind the scenes to maximize the government's chances for success.

The PFP emphasizes:

Reduction in recurrent expenditures
Reduction in inflation
Rise in productivity
Reduction in dependence on copper
Downward adjustments to the exchange rate
Relaxation of import controls
Tightening of the money supply (including a change in currency notes)
End of price controls (for agricultural products too—except for maize)
Real positive interest rates
Reform of the parastatal sector including partial privatization
Establishment of a stock exchange
Phaseout of maize subsidies with protection for vulnerable groups (coupon system to ensure a minimum ration per family)
Reduction in size of the civil service, with a pay raise for those remaining
Savings from above to be channeled into social services, especially health and education.

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1990

The National Convention debates multiparty democracy. The president and UNIP agree to put the matter to a national referendum. The government controlled media begins a smear campaign against the multiparty lobby.

The PFP helps generate new international support. IMF and World Bank-led efforts yield aid pledges of $480 million.

A dual exchange rate system is introduced. One rate is for government purchases of medical and educational supplies and to value debt-servicing. The other rate, called an incentive rate, covers all other transactions and is adjusted to encourage exports and foreign investment. The exchange rate is now actively managed by the central bank and in a manner consistent with the interplay of market forces. The IMF and World Bank sanction the system.

Maize price increases cause new riots and put in question the expected win of UNIP's sole political party position on the national multi-party referendum.

A Canadian national is appointed governor of the Central Bank. The measure is taken to restore the government's badly damaged credibility in the wake of Central Bank mis-management.

Government announces that a number of state companies will be placed under private management and others will be fully privatized.

Government liberalizes maize marketing:

Farmers no longer required to sell their maize to provincial cooperative marketing unions
Now have choice of selling directly either to millers or to consumers.

Negotiations for the payment of arrears to the IMF $1.2 billion and the World Bank $400 million have been a trouble spot in securing other credits and rescheduling. But a unique system of accumulating borrowing rights from the Fund's Enhanced Structural Adjustment Facility (ESAF) breaks this logjam. Maintenance of the current reform program is a necessary condition.

Transportation routes are re-established, and trade restrictions are lifted with South Africa in response to political liberalization measures under way in that country.

III. Analysis of the Reforms

A. Timing

- **Zambia's first structural reform bid was put in motion by its 1983 agreement with the IMF.** This Economic Recovery Program was precipitated by a severe 40 percent drop in the nation's terms of trade between 1980 and 1982.

- **The political backdrop for reform was highly adverse.** Political unrest was evident from the mid-1970s, when President Kaunda declared a state of emergency. The early 1980s witnessed a coup attempt, a major cabinet shakeup, changes in the UNIP leadership, the detention of several trade union leaders and growing popular resentment over declining living standards. Amid all this turbulence, the Kaunda government was never able to successfully build a consensus around economic reform.

- **The credibility of the government's reform efforts may have been contaminated by widespread public perceptions of official corruption.** Some analysts contend that the December 1986 riots were an expression of outrage against perceived corruption within the ruling UNIP as much as they were a protest against rising prices and deteriorating economic conditions.

- **The riots sparked major policy reversals, particularly the reinstatement of the maize subsidy, the cessation of IMF relations, and the freezing of the exchange rate.** Significantly, however, a complete about-face did not occur. Officials retained key liberalization measures in farm pricing. At the same time, however, the freezing of the exchange rate worked as a disincentive to the agricultural export sector.

- **By 1989, the failures of the self-help approach were clear and Zambia had virtually no options other than orthodox adjustment.** Continued high inflation, shortages and general economic distress provided political space for Kaunda to pursue— albeit cautiously— an orthodox IMF-type adjustment package. Kaunda went ahead and began reform policy implementation (exchange rate adjustment and price deregulation, among other measures) before formally embracing an IMF pact.

- **The debt relief and new loans and aid accompanying the adoption of the IMF reform program in 1990 will provide important balance-of-payments relief.** Zambia's return to the road of reform will benefit from external support, which in 1990 amounted to approximately $500 million. A major objective is restructuring Zambia's multi-lateral arrears which amount to about $1.25 billion.

B. Sequencing

- **When Zambia turned up the heat on economic reform in 1985, two of the measures taken had a particularly high social impact.** Both the liberalization of the foreign exchange system and withdrawal of the maize subsidy had serious inflationary implications for consumers. Some analysts have questioned the prudence of attempting to realign maize prices soon after the currency had undergone a heavy devaluation, particularly given the highly contentious political climate of the time.

- **In general, authorities underestimated the social impact of reform measures.** Government-provided subsidies and services were a very pervasive feature of the economy for many years. Any reduction in these benefits was likely to be strongly resisted by a people who had been experiencing a steady economic decline for close to a decade. Had the reform policies of 1983-85 succeeded in bringing about the start of a recovery, the subsidy withdrawal and the like might have been less fiercely resisted.

- **The timing and sequencing of the liberalization of credit and foreign exchange markets have also been questioned.** Criticisms center on the continued weakness of Zambia's external sector and low levels of market confidence in the system's potential success. Given these shortcomings, the auction mechanism for foreign exchange allocation may have been too radical a form of liberalization.

- **Effective action on the fiscal front would have improved the odds for successful financial market liberalization.** However, authorities never were able to contain spending and bring the fiscal deficit down to manageable levels. The acute fiscal imbalance undermined all other major reform undertakings.

- **Only very recently has the important area of parastatal reform and privatization come into play.** The vast parastatal system in Zambia has been ripe for reform for a long time. The government now has plans to speed the liquidation, privatization or

simulated privatization of a number of parastatal operations. Expatriate managers are being hired to turn parastatals around. A stock market is reportedly being established to value properties as a prelude to divestment.

Worksheet for Zambia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1982		Reform Period 1983-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	50%	4.5
		Low and Uniform Tariff Barriers	6	40%	2.4	60%	3.6
		No Local Content Regulations	4	40%	1.6	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	60%	5.4
		Minimal Exchange Controls	5	30%	1.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	60%	4.2
		Minimal Preferential Interest Rates	1	30%	0.3	50%	0.5
		Equal Access to Capital	3	30%	0.9	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	70%	4.9
		Minimal Subsidies	4	30%	1.2	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	40%	2.4
		Reduced Marginal Tax Rate	2	40%	0.8	50%	1.0
		Equitable / Uniform Tax Collection	2	30%	0.6	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	40%	2.0
		Franchise Out State Services	2	20%	0.4	70%	1.4
		Simulated Privatization	3	20%	0.6	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	40%	2.4	60%	3.6
		Proactive Promotion	1	40%	0.4	60%	0.6
2	Information	Free Flow of Market Information	2	40%	0.8	60%	1.2
16	Enabling Environment	Private Property Rights	9	40%	3.6	60%	5.4
		Efficient Gov. Administration	2	30%	0.6	40%	0.8
		Legal and Accounting System	2	40%	0.8	50%	1.0
		Infrastructure	3	40%	1.2	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	32.2	31.9	57.0	57.2

ZAMBIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	3.0	6.2	-2.8	-2.0	-0.4	1.6	0.6	2.7	6.3	0.1
By sector: Agriculture	-1.9	8.2	-11.7	8.4	5.6	3.5	8.7	-2.2	20.5	--
Industrial Activity	2.3	5.0	-0.6	-3.2	-2.8	1.2	0.2	2.7	6.5	--
Services	5.4	6.5	-1.6	-4.3	-0.7	1.4	-1.3	3.7	1.7	--
Per Cap. GNP-Current US $	600	720	660	560	460	370	260	240	300	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	6.28	5.48	4.87	5.05	4.47	4.30	4.07	3.87	3.69	3.52
Purchasing Index, US=100	105.10	104.02	108.71	83.86	58.64	50.25	68.41	66.56	66.76	72.31
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	1.11	1.04	0.85	0.73	0.78	0.70	0.73	0.72	0.77	--
Exports (fob) (1980 prices)	1.36	1.23	1.35	1.35	1.35	1.22	1.06	1.05	1.00	--
Current Account	-0.54	-0.74	-0.57	-0.27	-0.15	-0.40	-0.30	-0.14	-0.20	--
Capital Account	0.32	0.28	0.18	0.25	0.06	0.23	0.20	-0.12	--	--
Changes in Reserves	-0.003	0.36	-1.00	0.03	0.09	-0.09	0.19	0.10	0.08	--
External Debt	3.27	3.63	3.71	3.77	3.82	4.64	5.64	6.45	6.50	--
Interest Payments (on foreign debt)	0.12	0.09	0.09	0.08	0.06	0.04	0.06	0.06	0.07	0.06
Export Growth %	-10.2	-9.7	9.7	0.0	0.6	-9.6	-13.1	-1.1	-5.3	--
Terms of Trade % Change	-7.7	-20.2	-11.1	10.0	-10.0	1.9	0.0	11.5	34.5	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

ZAMBIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	11.7	14.0	12.5	19.6	20.0	37.4	51.6	43.0	55.8	--
Fiscal Deficit (-)/Surplus as a % of GDP	-18.5	-12.9	-18.6	-7.8	-8.4	-14.9	-26.9	-13.7	-12.9	--
Investment Share of GDP %	23.3	19.3	16.8	13.8	14.7	14.9	23.8	12.7	11.4	--
Savings Share of GDP %	19.3	6.8	8.0	15.2	16.5	14.1	22.1	13.9	13.9	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	--	--	--	--	--	--	--	--	--	--
Government Share in Economy %[2]	35.7	33.7	36.2	30.4	28.3	29.1	38.7	35.6	21.9	--
Gross New Foreign Investment (US mn$)	61.2	-38.9	39.0	26.0	17.0	52.0	--	--	--	--

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

INDIA

INDIA

General Assessment of Reform

- **The scope of India's reform program since 1984 has been extensive and ambitious, but the program leaves substantial structural changes to still be accomplished.** When the reforms began, the government's involvement in the Indian economy was probably more extensive than in any other non-Communist country. The reform program has largely been directed at liberalizing, rather than replacing, India's traditional developmental strategy. Specifically, the program has attempted a modification and eventual reversal of import-substitution policies; a reduction of very high marginal tax rates: the establishment of a more realistic exchange rate system; and a relaxation of the national industrial licensing system, which had rigidly controlled output. Reduction in the size of the government and privatization of the many nationalized industries were never an issue in these reforms.

- **The actual objectives of government action have been considerably more modest.** Exports have been encouraged somewhat, and multinational investments have been discouraged. In addition, the tax rates have been lowered to a degree. The rupee, through flexible exchange rate management, was devalued 25 percent in real terms between 1984 and 1988. Most importantly, businesses have been given greater latitude in determining their production volumes. The reform effort has received adequate political backing. Broad, though not universal, support for the program exists, allowing reforms to continue, albeit slowly. However the bureaucracy remains an obstacle to reform; it has not shifted to a Japanese style pro-growth orientation.

- **To a large degree these reforms reflect a generational change in the country's leadership.** The initial steps toward liberalization began under Indira Gandhi's last administration, but were inspired by her son Sanjay. Many of the people involved were young professionals who were not wedded to the socialist ideals of India's independence movement. When Indira's other son Rajiv became prime minister, the broad portfolio of reforms, including an emphasis on high technology and greater reliance on the country's capital markets, was put forward as a program to boost growth and development. Some critics, however, suggested that the program's main goal was to

improve the lifestyle of India's large and growing urban middle class.

- **The large number of wide-ranging economic reforms has generated modest and somewhat mixed results.** Total foreign investment in India increased from US$13.7 million in 1981 to US$121 million in 1988, a level equal to one modest project in most industrializing countries. Exports have increased, but so have imports. Thus the current account balance has deteriorated. Even worse, the fiscal deficit has increased, along with the external debt. Industrial growth during the reform period averaged about 1 percent more than in the preceding period. The reforms in the financial markets have generated increases in capitalization and in the number of firms publicly listed.

- **Despite the seemingly wide breadth of these reforms, their relatively mild intensity has resulted in a mixed impact on the nation.** The main effect has been social in nature: the urban middle class appears to be living better and consuming larger quantities of expensive imports. This has increased support among much of the educated professional class, but has also resulted in significant amounts of populist opposition among the country's socialists. The reform issue, however, has generally been of less concern than the dominant political issues in India, which continue to be caste, religion, and rural poverty.

- **One of the more important consequences of the reform program has been the marked change in the perception of India in the global market.** India's size, especially its large and well-educated middle class, makes the country an attractive market to a wide range of multinationals. Since the country's independence, however, India has either been avoided or actually abandoned by most international firms, due to the difficulty of doing business there. Since the reform process began, however, global interest in doing business in India appears to be on the rise. Substantial benefit from this interest may occur in the future.

- **Support for the reforms has continued in subsequent administrations.** The government of V.P. Singh, which followed Rajiv Gandhi, continued to pursue the objectives of the reform program, although support was weakened by economic problems associated with the budget and current account deficits. The recently elected government of Chandra Shekhar, though critical of multi-national involvement in India, appears to be focusing its counter-reform efforts primarily on the populist issue of reducing "luxury" imports.

I. Background to Reform

India has made attempts at economic reform since the late 1960s, when industrial and trade liberalization policies were first proposed. The first oil shock prompted the beginning of important structural changes by Mrs. Gandhi as the need for greater economic efficiency was stressed. Mrs. Gandhi's return to office in 1980 brought more coherent, though still cautious, steps toward liberalization that were inspired initially by her son Sanjay. Later, more senior, forward-looking officials guided the process.

When Mrs. Gandhi's other son Rajiv assumed the office of prime minister in 1984 after her assassination the previous year, he undertook far-reaching economic reforms. Industrial regulations were liberalized, reforms were introduced to promote exports, and ease restrictions on imports and foreign investment and steps were taken to boost the growth of India's capital markets. The moves toward economic reform were greatly influenced not only by the prime minister's own convictions and background but also by the World Bank and the IMF.

II. Evolution and Chronology of India's Economic Reform

1980-82

Mrs. Gandhi and the Congress party resume leadership of the government.

Under Mrs. Gandhi, initial cautious steps are taken toward liberalization.

1982

IMF loan of US$5.5 billion is secured to bolster foreign exchange supply.

1983

The assassination of Mrs. Gandhi.

1984

Rajiv Gandhi, as the new prime minister, begins program of far-reaching economic reforms.

Liberalization of industrial licensing system:

Industrial licensing eliminated for 25 industries
"Broadbanding" is introduced as a means of giving greater flexibility by establishing broader licensing categories

Centralization of licensing administration
Easing of limitations imposed on large companies by anti-monopolies legislation
Extension of small-scale sector protection measures to larger units.

Liberalization of rules governing the licensing and importation of capital goods in "high-tech" industries:

The White Paper on Technology Policy, January 1984:

Recommends measures to increase imports of modern foreign technologies and to provide greater support for indigenous research and development.

Particular attention given to electronics:

Excise duties are cut
Import duties eliminated for computers, and tariffs cut for their principal components
Encouragement of foreign investment in electronics sector
Use of public subsidies or public enterprise to develop electronics.

Measures are introduced to improve the performance and reduce the dominance of nationalized industries:

Private enterprise is allowed into areas previously reserved for public sector
Private sector is encouraged to finance itself independently through private capital, as opposed to government credit
Public enterprises are required to pursue commercial pricing policies
Public corporations lose their monopoly on some imports
Technological improvements are stressed to raise efficiency of public enterprises.

Export promotion measures:

Tariff and licensing concessions are granted on key machinery spares and their inputs
Export taxes are removed from almost all items
Complex system of export subsidies improved
Free trade zones established.

1985

Agreement on the Seventh Plan, covering 1985-90. Main objectives are:

Economic growth averaging 5 percent a year
Agricultural growth of 4 percent a year
Industrial growth of 8 percent a year
Poverty alleviation.

Tax incentives are implemented:

Corporate tax rate is cut from 55 percent to 45 percent over three years and a surtax on corporate income tax is eliminated in the third year
Income tax threshold is raised, tax structure simplified and maximum rate is reduced from 62 percent to 50 percent
Wealth tax is lowered from 5 percent to 2 percent.

Further industrial licensing system liberalization:

Seven more industries have industrial licensing eliminated.

Government enacts new series of tax measures:

Non-agricultural, non-corporate income tax rates are reduced across the board; highest marginal rate reduced from 60 percent to 50 percent
Surtax on "excess" profits to be discontinued after 1987
A uniform rate of 30 percent is established for taxing royalties and fees for technical services
Government abolishes the scheme of compulsory deposits by income tax payers
Steps taken toward improving tax administration including granting amnesties and widely publicizing punishments of tax evaders.

Government de-licenses 82 pharmaceutical products.

In March 1985 budget, import duties applied to project imports drastically reduced.

Import-Export Passbook Scheme introduced to streamline advance licensing procedures.

1986

Administered Price Policy paper is issued; paper recommends abolishing plant-specific, cost-plus "retention pricing" and supports better cost recovery for public enterprise.

Policy decisions are announced by a Cabinet Committee on Exports:

- Duty-free or low duty import is allowed for capital goods in identified "thrust" industries with good export growth prospects
- Facility for supply of domestic raw materials at international prices is extended to all major export sub-sectors
- Exporters are allowed to retain 5 percent to 10 percent of foreign exchange earnings for export promotion activities.

Modified Value-Added Tax (MODVAT) is announced as a step toward reform of the excise duty system.

Business income tax deduction is liberalized.

International Price Reimbursement Scheme (IPRS) is expanded to include producers of aluminum and aluminum products, as well as iron, steel and special alloy steels.

Interest rates to exporters are reduced from 12 to 9.5 percent.

Faster processing of export credit and duty drawbacks.

Additional series of measures is introduced in October/November to stimulate exports:

- IPRS is extended to raw materials for all major export sectors
- Permission to retain 5-10 percent of foreign exchange receipts for export promotion is granted
- Duty-free capital goods imports for exporters in "thrust" industries
- Full remission of excise duties and domestic taxes
- Remission of 20 percent of interest charges on IDBI loans for firms exporting over 25 percent of output.

1987

1987-88 budget extends MODVAT to all commodities other than textiles, tobacco and petroleum products.

Further reform of direct taxes is proposed:

Depreciation based on block of assets rather than individual
Reforms of capital gains tax.

Minimum corporate income tax is proposed on 30 percent of book profits.

In the wake of the monsoon, the government announced increases in income, wealth and corporation taxes and customs duties aimed at high-income groups.

1988

Government introduces second 3-year economic plan covering 1988-91:

Tax and tariff concession incentives are established to promote export growth
Some import licensing controls are eased.

Minister of Finance announces a 10 percent across-the-board operational expenses cut to help reduce budget deficit.

1988-89 budget entails a significant investment in infrastructure with 47.8 percent of expenditures allocated for infrastructure improvements.

Government restricts industry licensing to 27 specific areas.

Industrial licenses to be automatically re-endorsed for productive capacity at maximum levels of production achieved in two years.

Establishment of the Securities and Exchange Board of India (SEBI) to regulate exchange and the Credit Rating and Information Services of India, Ltd. (CRISIL) to rate capital issues.

99 new capital goods become eligible for import under Open General Licenses program.

Incentives announced to attract foreign investment:

"Phased Manufacturing Programs" (PMPs) regulations relaxed Foreign firms allowed to set up projects without an Indian firm as collaborator.

Replenishment (REP) licenses are extended to benefit virtually all exports.

1989

Revenue Department steps up tax collection efforts:

50 percent increase in collection of direct taxes results.

Elections are held in November; V.P. Singh (former Finance Minister) becomes new Prime Minister as leader of the centrist Janata Dal Party.

1990

Government under V.P. Singh commits to further policies for economic liberalization:

Deregulating domestic industry
Increasing exports
Encouraging foreign investment.

Prime Minister Singh announces an austerity plan to reduce the budget deficit:

Six months later it is largely viewed as a failure.

Country experiences current account and a growing budget deficit.

Political dissension in the government threatens to undermine economic reform efforts.

Industrial policy in May is put on hold due to political pressures:

Policy reformed licensing requirements, import clearance, and foreign investment approvals.

Prime Minister Singh's announcement that 27 percent of public-sector jobs will be reserved for "backward" castes causes a virtual war amongst the Hindu castes.

Janata Dal Party splits:

In November elections, V.P. Singh's Janata Dal People's Party is voted out of office.
Chandra Shekhar, leader of the new Janata Dal (S) - for "socialist"- becomes the new prime minister.

III. Analysis of the Reforms

A. Timing

- **India's attempts at economic reform in the 1960s lay the foundation for the far-reaching reform program that evolved in the 1980s.** Moves were made in the late 1960s to liberalize industrial and trade controls, but Mrs. Gandhi refused to loosen the government's grip on the economy. It was not until the Indian economy had felt the effects of domestic crises in the mid- 1960s and external shocks in the 1970s that Mrs. Gandhi began to relax price and distribution controls. Later, in 1980, influence from her son Sanjay prompted Mrs. Gandhi to initiate a number of conservative industrial and trade liberalization measures.

- **The reform process that began under Mrs. Gandhi generated a certain momentum that Rajiv Gandhi, as the new prime minister in 1984, was able to exploit.** Rajiv's own commitment to economic reform was fueled by the cadre of Indian and foreign technocrats who surrounded him most of his adult life. Also, the experience he had as an advisor to his mother before succeeding her was instrumental in shaping his reformist stance. Rajiv found support for his reforms in the economic bureaucrats who came from an important segment of India's elite. This group was greatly influenced by the currents of international thought that favored market-based economics. At the same time, an active and powerful lobby from the private sector was also demanding change.

- **The impetus for change started with domestic forces but was given a boost from the World Bank and the IMF.** The award of a large IMF loan in 1982 was significant to the onset of the reform process. The US$5.5 million loan was secured to correct the deteriorating balance-of- payments situation and to assist the government in achieving monetary control. But the IMF was also interested in steering the Indian authorities in the direction of policies that contained medium and long-term implications for liberalization.

- **The pace of reform slowed in 1990 under the government of V.P. Singh.** The new government's initial commitment to continued reform was side-tracked by political dissension due to the government's inability to deal with budget and current account deficits and growing inflation.

- **Under the current government of Chandra Shekhar no advances in reforms are expected.** The main economic issues concern inflation and deficits. When these are dealt with, many expect that Rajiv Gandhi will return to power and the reforms will continue.

B. Sequencing

- **Among the first areas addressed by Rajiv Gandhi's administration in 1984 were the industrial licensing system and the licensing and importation of capital goods in high-tech industries.** Reforms were also enacted to promote more efficient scales of production. The general emphasis was to reduce the bureaucracy's ability to slow development.

- **Over the next three years, a number of tax and tariff issues were addressed to improve business incentives.** Marginal tax rates were lowered and some simplification and streamlining of the tax code took place. Selective reductions were made in import duties on capital goods for targeted industries. Many of the changes were highly targeted to provide incentives for specific developmental objectives, rather than across-the-board tariff reform, reduction, and simplification.

- **In the following years, further tinkering with licensing, tax, and trade incentives took place.** Although the stated goal continued to be broad-based reform, the underlying orientation moved back toward modest policies designed to achieve fairly specific government objectives through the use of incentives (rather than sectoral regulation).

Worksheet for India

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1983		Reform Period 1984-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	40%	3.6
		Low and Uniform Tariff Barriers	6	20%	1.2	50%	3.0
		No Local Content Regulations	4	10%	0.4	30%	1.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	50%	4.5
		Minimal Exchange Controls	5	20%	1.0	40%	2.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	60%	4.2
		Minimal Preferential Interest Rates	1	30%	0.3	50%	0.5
		Equal Access to Capital	3	20%	0.6	50%	1.5
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	50%	3.5
		Minimal Subsidies	4	20%	0.8	40%	1.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	40%	2.4
		Reduced Marginal Tax Rate	2	20%	0.4	40%	0.8
		Equitable / Uniform Tax Collection	2	50%	1.0	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	10%	0.5
		Franchise Out State Services	2	10%	0.2	10%	0.2
		Simulated Privatization	3	30%	0.9	40%	1.2
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	30%	1.8
		Proactive Promotion	1	10%	0.1	50%	0.5
2	Information	Free Flow of Market Information	2	60%	1.2	70%	1.4
16	Enabling Environment	Private Property Rights	9	50%	4.5	60%	5.4
		Efficient Gov. Administration	2	20%	0.4	40%	0.8
		Legal and Accounting System	2	60%	1.2	60%	1.2
		Infrastructure	3	40%	1.2	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	28.7	28.7	44.8	44.7

INDIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	6.5	6.6	4.0	7.3	3.4	6.6	4.6	3.0	9.6	--
By sector: Agriculture	12.5	5.7	-1.6	10.6	0.1	0.3	-2.3	-1.0	16.0	--
Industrial Activity	3.2	7.9	4.7	9.7	6.5	8.2	8.4	6.5	8.8	--
Services	4.4	5.4	6.9	4.8	6.0	7.3	6.2	5.1	6.3	--
Per Cap. GNP-Current US $	240	270	280	280	280	290	290	310	340	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	5.39	5.46	5.40	5.51	5.81	5.95	5.34	5.71	5.77	5.66
Purchasing Index, US=100	46.08	42.44	37.51	37.50	33.51	33.17	37.56	39.38	36.37	32.41
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	14.09	15.16	15.04	15.87	16.57	18.97	18.69	19.05	21.00	--
Exports (fob) (1980 prices)	8.33	7.95	8.92	9.11	9.27	9.09	9.79	11.19	12.23	--
Current Account	-1.79	-2.70	-2.52	-1.95	-2.34	-4.18	[illegible]	-5.19	--	--
Capital Account	0.12	0.52	0.83	1.20	3.41	3.78	4.19	5.32	--	--
Changes in Reserves	1.54	2.58	1.86	0.73	-0.94	-0.08	0.26	-0.32	--	--
External Debt	20.56	22.57	27.38	31.89	33.86	40.89	48.35	55.32	57.51	--
Interest Payments (on foreign debt)	0.37	0.37	0.47	0.57	1.03	1.31	1.73	2.09	2.55	3.10
Export Growth %	-10.1	-4.6	12.3	2.1	1.8	-2.0	7.7	14.3	9.3	--
Terms of Trade % Change	-7.6	6.0	2.0	6.5	2.5	-3.3	4.0	-2.8	0.8	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

INDIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	11.4	13.0	7.9	11.9	8.3	5.6	8.7	8.8	9.4	--
Fiscal Deficit (-)/Surplus as a % of GDP	-6.5	-5.5	-6.0	-6.4	-7.7	-8.5	-9.1	-7.9	--	--
Investment Share of GDP %	22.8	25.7	23.5	22.7	23.1	25.9	24.3	22.5	23.8	--
Savings Share of GDP %	19.2	22.5	20.7	20.4	20.7	22.8	21.6	19.9	21.1	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	95.0	105.0	111.0	121.0	129.0	131.0	--	--	--
Government Share in Economy %[2]	11.7	11.4	12.1	12.1	13.2	14.2	15.3	15.3	17.6	--
Gross New Foreign Investment (US mn$)	--	--	--	--	--	--	--	--	--	--

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

INDONESIA

Prepared for the Center for International Private Enterprise

INDONESIA

General Assessment of Reform

- **The structural reform in Indonesia was broad in scope, touching on exchange rates, fiscal and tax policies, banking and finance, international trade, and foreign investment.** The effort had two overarching objectives: to restore financial stability to an overextended economy, and to sustain long-term economic development through diversification of exports. As part of a strict macroeconomic policy, the currency was devalued to reflect market forces. In addition, tax laws were revised and fiscal expenditures were reduced. There was also a move to market interest rates, and capital markets were liberalized. Finally, trade and tariff laws were rationalized and restrictions on foreign investment were reduced. The most significant shortcoming of this program has been in the area of privatization. State-owned industries continue to play a major role in the economy, and to date have resisted any significant moves toward privatization.

- **In general, reform has been pursued with considerable intensity.** In most areas there were a number of reforms over a series of years with each reform making advances over previous moves. In general, these reforms were aimed either at achieving increased reliance on market forces or in maintaining goals achieved. For example, to keep exchange rates in line, there were two major devaluations following the fall in oil prices in 1983 and 1986. In 1988, exchange rates were tied to a market- based formula. In restructuring the financial markets and opening up the economy to foreign investors, there has been a similar pattern of reform-building-on-reform.

- **At the time the reforms were instituted, the Indonesian economy was suffering from low growth and balance-of-payments problems.** The collapse of oil and other commodity prices in the early 1980's, combined with the deep worldwide recession, brought about a major deterioration in Indonesia's terms of trade and a significant fall in its exports. By 1982, the country's current account deficit had grown to $7.2 billion. A vast number of

major capital projects no longer seemed financially viable. A wide range of fiscal, trade, and investment inefficiencies that had been tolerable during the earlier boom period now seemed to be crippling the government's ability to deal with the crisis.

- **These reforms have significantly changed Indonesia as well as its relationship with the world economy.** From 1982 to 1989 there was virtually no change in the dollar value of Indonesian exports, but the mix of exports changed dramatically. Petroleum products dropped to a third of their former level while non-petroleum exports more than tripled in value. In addition, foreign direct investment in the country increased dramatically. At the same time, the average annual inflation rate dropped from about 13 percent in the previous period to about 7.5 percent in the period the reforms began.

- **Indonesia's reforms have largely been the result of home-grown efforts within the country's governmental leadership.** The World Bank and the IMF have been highly supportive of the Indonesian reform efforts, but the actual leadership has come from Western-educated "technocrats" within the government, the so called "Berkeley mafia." This group has favored the development of industries where the country has a clear competitive advantage in international markets. Support, however, has not been unanimous. From the beginning, there has been strong intellectual opposition from a group of "economic nationalists" who favor economic independence and the acquisition of new skills and technologies.

- **These reforms were implemented by a long-established authoritarian government against, in part, the vested interests of an entrenched bureaucracy.** Since independence in the 1940s there have been only two heads of state in Indonesia: Sukarno and Suharto. Both have ruled with military support, with Suharto taking power as the result of a military coup. For most of its national history, the dominant development approach rested on equally authoritative central planning with nationalized industries. Thus, support for the reforms was grudging and reluctant among the central planners in the government for philosophical as well as self-interest reasons. Initially, the traditional patron-client structure of Javanese politics prevented bureaucratic sabotage to the reforms.

Ultimately, however, the reform's successes seem to have silenced much of the criticism among the central planners in the government.

- **Corruption was another important area in need of reform if the country was going to increase trade and attract investment.** Anticorruption was not an explicit target of the reform program. There were areas, however, where existing corruption was impeding progress. At lower levels of government, such as the customs service, corruption had traditionally provided a significant source of employee income. This problem was dealt with through a unique form of privatization: the customs service was disbanded and a Swiss firm was hired in its place. As a result, revisions in tariff laws alone helped free up market forces and increase the flow of international trade.

- **The government continues to own and operate an extensive network of state businesses.** The actual number of these businesses, officially about 200, is unclear. Some unofficial estimates have suggested that the government may be involved in yet another 200 or more enterprises. These businesses generally have been a financial drain on the government. However, privatization, though frequently suggested, has consistently been resisted due to strong opposition from the left and from powerful privateers, who make large amounts of money from government contracts through close connection with the state-owned firms. Another source of opposition comes from the fact that the Suharto family is deeply involved with many of these enterprises.

I. Background to Reform

A worsening external environment prompted President Suharto's policymaking team to institute a major adjustment program in 1983. The rehabilitation policies of the late 1960s and the growth-oriented approach of the Repelita I-III development plans were abandoned as Indonesia first turned to a strategy of strict macroeconomic policies to restore financial stability. Government spending was curtailed, monetary expansion was tightly controlled, and an exchange rate policy aimed at improving the competitiveness of the rupiah was adopted.

A major restructuring program, directed toward reducing the country's heavy dependence on oil as a revenue source and toward improving overall economic efficiency, was begun. This program was intended to sustain a momentum of economic development over the medium to long term. Market-based reforms were an important element in this program and were directed at reducing the high level of regulations and administrative control that had long existed in the Indonesian economy.

II. Evolution and Chronology of Indonesia's Economic Reform

1983-1984

President Suharto voted to a fourth term in 1983 elections.

Rupiah devalued by 28 percent to Rp970 to the dollar, restoring the competitiveness of non-oil exports and helping to reverse the large-scale capital flight.

Large-scale and capital-intensive public sector development projects were postponed, resulting in foreign exchange savings of $5 billion.

Liberalization of the banking system:

- Controls on interest rates abandoned
- System of sectoral credit ceilings lifted
- Abolishment of subsidized liquidity credits.

Introduction of SBIs (discount instruments) and SBPUs (money market securities) as:

- A source of short-term liquidity
- To promote the development of a freely-functioning money market.

Reforms of capital markets:

- Below par value trading allowed for stocks on the Jakarta stock exchange
- Opening of a bond market.

Substantial increase in approved domestic investment.

Development of new income tax law that extended coverage and collection rates.

Reduction of consumer subsidies on fuel and rice.

1985

Bapepam (the capital market executive board) initiates further reforms:

Local private banks receive underwriting privileges for stock and bond issues
Capitalization and size requirements for new issues were revised to introduce new uniform minimum requirement of Rp200 million.

Sales tax is replaced by Value-Added Tax, levied at a rate of 10 percent on manufacturing and construction sectors and fuel oils.

Additional tax of 10-20 percent on luxury goods in domestic market.

Major steps taken to strengthen institutional aspects of tax administration:

Collection through withholding mechanism
Simplified guidelines for tax obligations and relief allowing for self-assessment and eliminating "tax bargaining" between taxpayers and tax officers.

Simplification of application procedures for foreign investments by BKPM (investment coordinating board):

Documents to be submitted by potential investors cut in half
Waiting period for applications reduced from 6 to 2 months
Charges to process investment applications discontinued

Signing of GATT Code on Subsidies and Countervailing Duties (CSCD) was a commitment to abolish all forms of export subsidies.

Reforms to reduce inefficiencies in shipping, port handling and customs procedures and improve Indonesia's export competitiveness:

Opened up domestic shipping industry to international competition
Reduced port charges
Simplified port administration
Notoriously corrupt customs service disbanded and customs duties job assigned to Swiss survey firm.

Across-the-board reduction in the range and level of nominal import tariffs:

Tariff ceiling reduced from 225 percent to 60 percent
Number of tariff levels reduced from 25 to 11.

Achieved self-sufficiency and substantial surplus in rice; only imports were a few thousand tons of non-domestically produced glutinous rice.

1986

Introduction of two new tax laws:

New property tax (PBB) based on a proportion of the market value of land and buildings, and a single tax rate of 0.5 percent
New law on stamp duties to reduce the large amount of transactions on which levies are payable to only two: above Rp100,000 and above Rp 1 million.

Reduction of customary subsidy on fertilizers and pesticides.

Raised efficiency of government departments and agencies responsible for implementing development projects:

Procedures for issuing project financing authorizations were streamlined
Option of carrying unspent development funds over to next fiscal year was suspended.

Further easing of restrictions on foreign investment:

All new investment projects were granted a one-year tax exemption on imported equipment and raw materials
BKPM lifted visa requirements on businessmen from 29 countries
Investment from East European countries permitted without prior approval of the national intelligence agency.

May 6, 1986 reforms (to promote non-oil exports and foreign investment):

Allowed "producer-exporters" the option of importing their inputs free of restrictions and exempt from import duties.

Foreign companies were granted the same privileges enjoyed by local companies:

Access to local currency from state-owned commercial banks
The right to distribute their goods without Indonesian intermediaries
General divestiture regulations were relaxed.

October 25 measures:

Two decrees from the Department of Trade and Department of Finance directly reduced the incidence of import licensing
Indication of shift to tariffs as the primary instrument of import policy.

September 12-31 percent devaluation of the rupiah.

1987

1987-88 Government budget called for continuation of reductions in capital expenditures:

Elimination of budget subsidies

Restraint of administrative costs.

January 15 Reforms:

Follow-up to October 25 measures with further reductions of import licensing
No tariff increases to offset the removal of license restrictions.

Capital markets reform package of December 1987:

Liberalized many regulatory controls over the market
Foreign investors granted limited access to the stock exchange
Establishment of a secondary "over the counter" market.

Resumption of rice output promoting policies to reverse dramatic slowdown.

Approval of 40 foreign investment projects in forestry totaling $400 million and resulting in Indonesia's status as the main exporter of wood and wood products in South East Asia.

1988

President Suharto elected to his fifth and final term in office-speculation begins surrounding his successor in 1993.

Pakto 27 Reform Package (October 1988); Liberalization of the financial sector:

Provided for new foreign bank entries
Reopened the market to domestic private banks (including provision of new foreign exchange licenses)
Provided for easier branching for existing domestic and foreign banks
Allowed private bank competition for the deposits of state-owned enterprises
Instituted longer maturities and regular weekly auction sales for central bank liquidity instruments
Introduced a 15 percent withholding tax on deposit interest rates to level the playing field vis-à-vis stock market dividends

Established more flexible, but stronger bank regulation
Reduced reserve requirements
Caused the BEI (Indonesian Stock Exchange) index to rise to a peak of 442 by the end of 1988 and then stabilize at 300 — an indication of major increase in activity.

November 1988 Reform Package:

Reform of the currency markets: Authorization was given for the rupiah's official dollar swap rate to be set by a market-based formula and the maximum maturity was extended from 6 months to 3 years
Liberalization of the shipping industry.

December 1988: Further financial sector reforms:

Several measures were introduced to enccurage foreign joint ventures and new firm entries into leasing, factoring, venture capital, securities trading, credit card, and consumer finance industries.

1989

May: A list of sectors closed to new foreign and domestic investment replaces previous lengthy and cumbersome priority list of open sectors for foreign investment.

Government announces that foreign portfolio investors could purchase up to 49 percent of the shares in all companies (except banks) listed on the Indonesian stock exchanges.

In accordance with the government's commitment to eliminate costly and distortive subsidies:

Artificial ceiling on domestic air fares is raised
Subsidy for agricultural pesticides is eliminated
Fertilizer subsidy is reduced.

October: Government announces refinements to 1988 financial sector deregulation packages in the areas of taxation, the stock market, and foreign banks.

November: Authorities announce measures affecting 186 out of more than 210 state-owned enterprises:

Government authorizes sales of equity in 52 state-owned enterprises
59 state-owned firms would undergo mergers of joint ventures
75 state-owned firms would undertake various steps to enhance efficiency.

1990

January 31: Prime lending rates of state owned banks reduced from 19 percent to 16 percent in line with government's relaxing of monetary policy.

March 1 opening of a Japanese department store signifies foreign investors first breakthrough into the Indonesian retail trade.

President Suharto calls for a divestiture of up to 25 percent of private firms' corporate equity to cooperatives in his January 4 budget speech; this amount was toned down to 1 percent in an agreement on April 5.

Middle East crisis creates a major policy dilemma for Indonesia as an OPEC member: boosting production to ease prices (favored by Saudi Arabia, OPEC's dominant producer) or waiting for the stockpiles of oil to drop.

Economic policy is increasingly dominated by the issue of distributional equity as the gap widens between the rich and poor.

Minister of Industry announces its plan to float up to 30 percent of the shares of three large state-owned cement companies, PT Semen Gresik, PT Semen Tonasa, and PT Semen Padang, on the Jakarta Stock Exchange.

Confidence in Indonesian economy provokes surge in foreign and domestic private investment:

Foreign investment:	Jan. 1 to April 21, 1990:	$2.5 billion
	1989:	$4.7 billion
	1988:	$4.4 billion

Domestic investment:	Jan. 1 to April 21, 1990:	Rp17,300 billion
	1989:	Rp19,600 billion

September: It is announced that foreign paper censorship will be abandoned, following weeks of intensified restrictions on the media.

December: Reports indicate that Indonesia is not fully committed to press liberalization and foreign paper censorship resumes.

III. Analysis of the Reforms

A. Timing

- **The initial impetus for reform came from the collapse of world oil prices.** The oil bonanza of the 1970s had made it possible for Indonesia's central planners to undertake huge development programs. These expansionary programs, however, along with the spending to develop the petroleum resources, led to overheating of the economy and inflation. When the oil price fell, a new engine of growth was needed and financial stability had to be reestablished.

- **The strong initial success of the reform program helped to sustain its momentum.** The initial devaluation brought an immediate improvement in the country's external position. The end of controls on interest rates resulted in a rise in real rates and the return of large volume of private capital. To reduce fiscal expenditures, major public sector development projects were rephrased which resulted in a $5 billion foreign exchange savings.

- **Some of the initial success was helped by the world economy.** When oil prices fell, the world's economy, led by the U.S., began to recover from the recessions of the early 1980s. The strong

expansion in world demand from 1983 through 1989 provided a ready market for Indonesia's new export-driven reforms.

B. Sequencing

- **The first issue of importance in the reforms was financial stabilization.** The objectives were to reverse capital flight, reduce inflation, and strengthen non-oil exports. In the first two years, the reforms focused on devaluation, banking and capital market reform, and reduction in the fiscal deficit.

- **In the following two years, gross inefficiencies in the economy were attacked.** During this period the main emphasis was on rationalizing and simplifying the tax system, foreign investment authorizations, tariffs, port handling and customs procedures.

- **By the late 1980s the emphasis of the reforms was on opening the economy to foreign participation.** Foreign investors were granted access to the stock market, foreign banks were allowed a larger role in the economy, and foreign joint ventures were encouraged, as were foreign-owned export businesses. A key national resource industry, lumber, was opened to foreign investment.

Structural Reform Matrix (SRM)
Worksheet for Indonesia

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				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	30%	1.8	80%	4.8
		No Local Content Regulations	4	20%	0.8	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	80%	7.2
		Minimal Exchange Controls	5	50%	2.5	90%	4.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	80%	5.6
		Minimal Preferential Interest Rates	1	30%	0.3	80%	0.8
		Equal Access to Capital	3	30%	0.9	80%	2.4
11	Prices and Wages	Limited Wage and Price Controls	7	70%	4.9	90%	6.3
		Minimal Subsidies	4	30%	1.2	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	80%	4.8
		Reduced Marginal Tax Rate	2	40%	0.8	90%	1.8
		Equitable / Uniform Tax Collection	2	30%	0.6	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	30%	1.5
		Franchise Out State Services	2	20%	0.4	60%	1.2
		Simulated Privatization	3	20%	0.6	50%	1.5
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	80%	4.8
		Proactive Promotion	1	30%	0.3	80%	0.8
2	Information	Free Flow of Market Information	2	30%	0.6	50%	1.0
16	Enabling Environment	Private Property Rights	9	70%	6.3	80%	7.2
		Efficient Gov. Administration	2	20%	0.4	60%	1.2
		Legal and Accounting System	2	40%	0.8	60%	1.2
		Infrastructure	3	40%	1.2	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	33.9	37.5	71.7	74.6

INDONESIA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	9.9	7.9	2.2	5.9	6.7	2.5	5.9	5.0	5.6	7.2
By sector: Agriculture	6.9	4.8	1.1	1.9	4.2	4.2	2.6	2.8	3.3	--
Industrial Activity	7.7	5.1	-7.8	2.3	8.1	0.9	4.4	1.6	5.3	--
Services	9.0	12.1	7.3	5.0	5.3	3.1	4.5	5.4	6.8	--
Per Cap. GNP-Current US $	470	560	610	580	550	520	490	440	440	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	9.32	9.86	10.24	10.32	10.02	9.65	11.87	12.72	13.70	14.84
Purchasing Index, US=100	46.43	46.78	47.80	36.91	32.33	31.71	27.95	31.84	33.29	35.75
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 Prices)	14.14	18.41	20.91	21.54	18.72	16.08	16.12	14.78	14.78	--
Exports (fob) (1980 Prices)	21.91	20.92	20.27	23.58	23.21	22.51	26.09	25.16	26.04	--
Current Account	2.86	-0.57	-5.32	-6.34	-1.86	-1.92	-3.91	-2.10	-1.40	--
Capital Account	-0.44	0.19	3.47	6.52	2.84	2.43	2.91	2.73	1.09	--
Changes in Reserves	-2.16	0.35	1.88	-0.17	-0.97	-0.57	0.93	-0.88	0.45	-0.42
External Debt	20.94	22.75	26.51	30.09	31.89	36.75	43.12	52.67	52.60	--
Interest Payments (on foreign debt)	1.18	0.99	1.55	1.61	1.91	1.92	2.35	2.62	2.91	2.97
Export Growth %	-2.9	-4.5	-3.1	16.4	-1.6	-3.0	15.9	-3.6	3.5	--
Terms of Trade % Change	20.7	5.7	-3.6	-5.4	1.0	-3.6	-25.8	0.4	-0.1	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

INDONESIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	18.0	12.2	9.5	11.8	10.5	4.7	5.8	9.3	8.0	--
Fiscal Deficit (-)/Surplus as a % of GDP	-2.3	-2.0	-1.8	-2.4	1.4	-1.0	-3.6	-0.9	3.0	--
Investment Share of GDP %	24.3	29.6	27.5	29.4	25.5	26.5	24.6	25.4	22.9	--
Savings Share of GDP %	37.1	33.7	27.9	28.3	30.5	28.5	24.9	28.1	26.0	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	108.0	123.0	128.0	127.0	139.0	143.0	--	--	--
Government Share in Economy %[2]	12.2	12.2	11.7	12.0	11.4	12.6	14.8	16.3	--	--
Gross New Foreign Investment (US mn$)	179.6	133.2	225.0	292.0	222.0	310.0	258.0	446.0	542.0	735.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

JORDAN

JORDAN

General Assessment of Reform

- **Jordan's commitment to structural economic reform is very recent.** The framework for reform was the Kingdom's 1989 IMF and World Bank agreements calling for basic stabilization and adjustment measures. Key targets were fiscal policy, the balance of payments, and inflation.

- **Jordan made significant reform progress within a short period of time, after committing to IMF and World Bank programs.** Jordan's economic policy team secured a pause in the crippling debt payment schedule, and reshaped the balance of payments in such a way that the country recorded a current account surplus in 1989, the first in almost a decade. However, the advent of the Persian Gulf crisis in mid-1990 created a host of new problems for Jordan, and the entire reform process has effectively been put on hold.

- **The Jordanian government successfully convinced a hostile legislature to accept a second wave of austerity measures following the April 1989 IMF pact, in exchange for greater political freedoms.** The newly elected Prime Minister Mudar Badran, facing heavy opposition from Parliament on proposals to cut spending and freeze public sector wages, managed to pass the proposals after committing to political liberalization measures, including abolishing martial law. Political analysts credit Badran, a veteran politician, with deft management of a very delicate policy issue. An earlier round of adjustment measures (price increases) triggered widespread unrest which resulted in major changes in the government.

- **Jordan's reliance on foreign aid will hamper its ability to generate self-sustaining growth industries.** Donor support has been the anchor of the nation's economic stability since its founding. In the past, help came from the U.K. and the U.S. More recently, Arab oil producers have provided important support. Jordan will need immense external assistance in the wake of the Persian Gulf crisis. Lost trade, aid, and worker remittances are expected to amount to 40 percent of GDP, according to one official Jordanian estimate. Much, if not all, of that lost income will have to be made up by international aid.

- **Jordan faces sizeable obstacles in its future efforts to bring spending in line with government resources. The Kingdom's domestic social needs have mushroomed as a result of the influx of Persian Gulf war refugees. Also, the nation faces permanently high defense and security costs.** The Kingdom has been involved in two major conflicts with Israel and did not join the moderate Arab states in opposing Iraq during the 1990-91 Persian Gulf conflict. While fiscal reforms have in recent years slowed the growth of defense outlays, military spending still accounts for more than 20 percent of government spending.

- **Jordan has opened its doors wider to non-Arab foreign investors.** Restrictions have been progressively eased since the mid-1980s. Foreign firms in general are now allowed to establish manufacturing enterprises in the Kingdom and retain total ownership. Joint ventures with local capital are no longer required. Restrictions on foreign investment still exist, however, in the trade and financial sectors. Overall, Jordan's biggest problem attracting new foreign investment may be investors' perceptions that the Kingdom is too close to the heart of a very volatile region.

I. Background to Reform

When Jordan's GNP growth was halted in the mid-1980s by a "reverse oil shock," the government responded in 1985 with a number of measures that were intended to sustain domestic demand and bolster exports. In a reversal of previous fiscal restraint policies, government expenditures swelled. These expansionary policies led, however, to an erosion of reserves and a growing external debt problem.

A tightening of foreign exchange, currency restrictions, and a ban on imports followed in 1988, but were not enough to stabilize the economy. The Jordanian dinar (JD) continued to lose ground, depreciating by more than one-third in value throughout 1988 before hitting rock bottom in August 1989. Additional disorder was created by King Hussein's announcement, in July 1988, of a severance of all legal and administrative links between Hashemite Kingdom of Jordan and the Israel-occupied territories to the west of the Jordan River. This announcement created great political uncertainty and may have resulted in substantial capital flight that was not captured in official statistics.

A readjustment program was launched under the auspices of the IMF in April 1989. The accord, begun under the short-lived government of Sharif Ben Shaker, was immediately followed by sharp

price rises on a wide range of staple items. Massive demonstrations broke out protesting the rises, in the worst domestic turmoil seen since the 1970 civil war. Sweeping changes ensued in top government and administrative posts, resulting in the Finance Minister and Central Bank governor being replaced. A general election was held in November 1989 and Mudar Badran, as the new prime minister, quickly affirmed his commitment to the IMF's program and to the introduction of far-reaching reform policies.

II. Evolution and Chronology of Jordan's Economic Reform

1980

Official transfers to Jordan rise nearly 300 percent in two-year period as Arab donor nations experience huge oil price windfall.

GDP growth expands 18 percent.

1982

Jordan's current deficit soars tenfold in one year.

1983

Modest quantities of crude oil are discovered, but the withdrawal of two foreign oil companies from prospecting in Jordan, rules out possibility of a major find.

1984

Jordan's GDP growth falls to 1.4 percent, from 20 percent one year earlier.

1986

World oil price crash.

September; the 1986-90 Five-Year Plan is unveiled; Plan endorses continuation of open and liberal trade environment, conservative monetary and fiscal policy, and a flexible interest rate policy.

Privatization is declared desirable objective:

Three public enterprises are identified for privatization: the Royal Jordanian Airline, the Public Transport Corporation, and the Telecommunications Corporation.

1987

Aid and remittances from Gulf Arab states fall off following oil price collapse.

Jordan's foreign debt and unemployment rate rise.

1988

Jordan experiences a foreign exchange crisis; Central-Bank imposed controls precipitate a full-scale run on the dinar.

Dinar is devalued; "managed float" follows.

A package of measures is introduced to conserve foreign exchange, including a one-year import ban on consumer durables.

Interest rates are deregulated.

Requirements for industrial licensing are streamlined.

King Hussein announces his decision to sever all legal and administrative links between Hashemite Kingdom of Jordan and Israeli-occupied territories to the west of the Jordan River.

An austerity budget is introduced for 1989.

Government bans import of luxury goods, due to acute balance-of-payments pressures.

1989

Jordanian government launches a readjustment program with the help of the IMF; compliance with the program will allow Jordan to draw down $125 million in IMF resources; Objectives, among others, are to:

- Reduce budget deficit from 24 percent of GDP to 10 percent by 1993
- Encourage export-driven economic growth
- Lower the inflation rate
- Eliminate external current account deficit.

Authorities raise prices on a wide range of staple items.

Jordan experiences its worst civil disturbances in 20 years:

- First time that unrest was not incited by outside forces
- Discontent fueled by economic austerity and demands for political change.

Sweeping changes take place in top government and administrative positions:

King Hussein sacks Prime Minister Zaid al-Rifai
Finance Minister and Central Bank governor are replaced.

Sharif Zaid bin Shaker, King Hussein's cousin, is appointed prime minister by the king:

New premier is given a brief to ease political climate and arrange a general parliamentary election.

Press liberalization drive begins in April:

By December, government relinquishes control of Amman's three daily newspapers.

World Bank economic restructuring loan is signed ($150 million).

Central Bank commits to the policy of tighter monetary control and begins to restrict money supply to control inflation (approaching 25 percent).

In response to the dinar's continuing depreciation, a two-tier exchange rate is introduced:

Official government rate for essential goods
Free market rate for non-essentials
Government aimed for unification of two rates by end of 1989.

Generally free and fair parliamentary elections take place on November 8:

Mudar Badran is elected prime minister.

1990

Government lifts ban on luxury consumer goods imports.

1990 budget is passed in second quarter and highlights include:

A reduction in the level of expenditure
A trimming of the budget deficit
A freeze on public sector wages.

A new income tax law is debated in Parliament:

Disagreement focuses on the level at which tax exemptions should be set.

Jordan is hit hard by the Gulf crisis:

An estimated 50 percent of GNP is slashed due to lost trade, workers' remittances, investments, and aid transfers.

Government doles out $55 million to provide food, shelter, and water for the 800,000 refugees fleeing Kuwait and Iraq via Jordan.

Unemployment rises to 30 percent.

III. Analysis of the Reforms

A. Timing

- **Jordan embraced an IMF-designed reform package in 1989, as a result of severe external imbalances and no viable alternatives to orthodox adjustment.** The Kingdom's economic difficulties had been steadily worsening since the 1986 world oil price crash, which drastically cut the amount of aid received from its Arab neighbors. The precipitating event leading to the IMF agreement came in January 1989, when major debt commitments came due that the Kingdom was unable to service.

- **While crisis conditions precipitated the reform effort, they may also sidetrack it.** Political and economic conditions in the country— and in the region as a whole— have changed dramatically as a result of the Persian Gulf crisis. It remains to be seen how successful the government is in averting major policy retrogressions. High unemployment and general economic distress will form hostile conditions for economic reform attempts that result in greater austerity.

- **Political liberalization was pursued in tandem with economic reform.** The tradeoff was explicit. Prime Minister Badran would likely have failed to pass key adjustment measures had he not agreed to political reform measures. Noteworthy is the fact that Prime Minister Zaid al-Rifai's government, in power when the IMF agreement was reached, experienced sharp resistance to austerity measures. These austerity measures were not accompanied by political reforms such as those promised by Badran. Badran's

success makes a credible case for mutual economic and political reforms.

B. Sequencing

- **Jordan took stop-gap measures to stanch the foreign exchange crisis before a broader adjustment program was enacted in 1989.** Emergency actions included import controls and a devaluation. Authorities also deregulated interest rates, presumably to coax investors into local investments and away from the foreign exchange bureaus.

- **A wide range of adjustment measures and reforms were put in motion by the 1989 IMF and World Bank agreements.** Key targets were government spending, monetary growth, foreign debt-rescheduling and inflation. Ambitious, but realistic, targets were set on the fiscal deficit reduction, which appeared to be a particularly important policy goal, given Jordan's chronic fiscal imbalances. The government had begun to move on all key reform fronts when the Persian Gulf crisis erupted in mid-1990.

Structural Reform Matrix (SRM)
Worksheet for Jordan

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1988		Reform Period 1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	60%	5.4	60%	5.4
		Low and Uniform Tariff Barriers	6	70%	4.2	70%	4.2
		No Local Content Regulations	4	70%	2.8	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	60%	5.4	70%	6.3
		Minimal Exchange Controls	5	50%	2.5	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	80%	5.6
		Minimal Preferential Interest Rates	1	70%	0.7	70%	0.7
		Equal Access to Capital	3	70%	2.1	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	60%	4.2	70%	4.9
		Minimal Subsidies	4	40%	1.6	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	40%	2.4
		Reduced Marginal Tax Rate	2	40%	0.8	60%	1.2
		Equitable / Uniform Tax Collection	2	30%	0.6	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	30%	1.5
		Franchise Out State Services	2	20%	0.4	30%	0.6
		Simulated Privatization	3	20%	0.6	30%	0.9
7	Foreign Investment	Non-Discriminatory Treatment	6	60%	3.6	70%	4.2
		Proactive Promotion	1	60%	0.6	70%	0.7
2	Information	Free Flow of Market Information	2	50%	1.0	70%	1.4
16	Enabling Environment	Private Property Rights	9	70%	6.3	70%	6.3
		Efficient Gov. Administration	2	60%	1.2	60%	1.2
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	60%	1.8	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	51.3	52.9	60.4	62.5

JORDAN

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	17.6	9.8	5.6	20.0	1.4	4.1	9.5	3.4	-2.1	-3.9
By sector: Agriculture	77.9	-9.7	1.8	-5.5	9.8	10.1	15.8	14.6	3.4	--
Industrial Activity	17.1	20.7	10.0	0.6	11.5	-2.8	0.1	5.2	-12.3	--
Services	14.1	0.2	9.1	3.9	6.0	3.6	4.5	4.1	-0.5	--
Per Cap. GNP-Current US $	1480	1640	1720	1630	1590	1530	1530	1560	1500	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	16.53	16.83	17.88	17.86	18.99	18.10	19.51	20.13	20.81	21.52
Purchasing Index, US=100	70.79	67.92	66.65	65.62	49.99	47.09	65.14	66.52	65.22	66.63
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	2.39	3.12	3.36	3.23	3.07	3.07	2.85	2.93	3.50	--
Exports (fob) (1980 prices)	0.56	0.75	0.81	0.67	0.87	0.95	0.81	1.02	0.99	--
Current Account	0.37	-0.04	-0.33	-0.39	-0.26	-0.26	-0.04	-0.35	-0.29	0.38
Capital Account	0.07	0.20	0.23	0.44	0.08	0.22	0.08	0.49	--	--
Changes in Reserves	-0.51	0.02	0.17	-0.05	0.32	-0.08	-0.13	-0.25	-0.04	-0.38
External Debt	1.98	2.30	2.66	3.07	3.45	4.04	4.61	5.36	5.53	--
Interest Payments (on foreign debt)	0.06	0.07	0.06	0.10	0.12	0.17	0.19	0.22	0.24	0.30
Export Growth %	25.0	33.7	8.2	-17.5	30.0	9.0	-14.3	25.9	-3.2	--
Terms of Trade % Change	-4.7	-3.4	-1.7	-2.5	2.8	-2.1	11.4	-5.6	17.0	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

JORDAN

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	11.1	7.7	7.4	5.0	3.8	3.0	--	-0.3	3.2	25.7
Fiscal Deficit (-)/Surplus as a % of GDP	-11.17	-9.96	-9.70	-7.62	-9.32	-9.53	-7.93	-9.31	-9.82	--
Investment Share of GDP %	41.1	50.5	46.9	35.9	32.4	30.5	29.6	26.4	26.1	--
Savings Share of GDP %	-9.0	-15.1	-17.1	-19.2	-16.8	-12.5	-3.0	-3.3	-3.3	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	105.0	110.0	109.0	101.0	98.0	97.0	--	--	--
Government Share in Economy %[2]	31.3	30.3	33.9	32.6	33.3	34.5	36.0	40.8	43.4	--
Gross New Foreign Investment (US mn$)	34.0	141.9	59.4	34.9	77.5	24.9	22.8	39.5	23.7	-1.3

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MALAYSIA

MALAYSIA

General Assessment of Reform

- **The Malaysian reform program focused primarily on improving the country's investment environment.** Up to the early 1980s the country had enjoyed healthy growth due to strong international markets for its raw material exports. When these markets fell in the mid-1980s and counter-cyclical fiscal policy failed to improve the economy, the country's nationalistic and socially oriented investment programs were greatly liberalized in order to encourage foreign and domestic investment in export-oriented industries. Some fine tuning was done in the area of foreign trade but no major changes were made in what was already a very open trade environment.

- **The reforms have been wide ranging and consistent in nature.** Government enterprises have been wholly or partially privatized. Patent and copyright laws have been revised. Foreign ownership restrictions have been liberalized by tying them to export and employment requirements. Tax laws have been revised to improve return on investment, and tariffs have been revised to support the shift from import substitution to export-oriented investment.

- **This reorientation in development strategy was largely due to the fact that in 1985 Malaysia's GDP fell for the first time in 20 years.** The effects of the earlier decline in the country's terms of trade had been dealt with largely through increased international borrowing and deficit spending.

- **Through 1989 the results of these reforms were mixed.** GDP growth recovered with 1988 (8.7 percent) and 1989 (8.5 percent) being the two highest in the decade, also well above the 6.8 percent averaged in the 1980-84 period. This improved growth was mainly due to the performance of the industrial sector. Real exports similarly rose to record highs while real imports remained flat. Despite these gains, the current account, though positive, continued to suffer from adverse terms of trade, and current dollar GNP per capita remained at or below 1984 levels.

- **The external debt acquired during the pre-reform period, though not crippling, contributed to this mixed performance.** Despite the fact that the reforms were intended to attract foreign investment, the country's heavy debt service moved the capital account negative. There was also a similar impact on investment

as a share of GDP which remained low despite continued high savings rates.

- **The economic, political, and social costs of the reforms have been minimal.** This has been largely due to the return to healthy levels of economic growth and the general lack of vested interest opposition to the reforms. The main Malaysian political conflicts continue to center on inter-racial issues within the country which the reforms have not directly addressed.

- **The reforms appear to have appreciably changed Malaysia's dependence on the highly volatile global commodity markets.** Prior to the reforms, traditional raw materials accounted for over 60 percent of the country's exports. By 1989 total exports were significantly higher and the raw material component was only about 35 percent.

- **On the whole Malaysia has pursued this reform program largely independent of major involvement by multilateral and foreign organizations.** The Malaysian foreign debt, though troublesome for the economy, has not required major restructuring. The U.N. Industrial Development Organization, however, did play an important role in developing an industrial master plan in 1986.

- **The primary political and economic issue troubling Malaysia continues to be racial relations, not structural reform.** The country is composed largely of three different racial groups: 58 percent Malay, 31 percent Chinese, and 10 percent Indian. The Malay are largely rural but politically dominant. The Chinese are urban and dominate the nation's commercial and business sectors. The Indians tend to play disproportionate roles in the law and the media. Much of the existing economic and industrial policy in place in Malaysia has been designed to improve the relatively underdeveloped economic status of the Malays. As a result, the reforms of the post-1985 period had to walk a narrow path between improving general economic performance and maintaining the programs designed to benefit the politically strong but economically weak Malays.

I. Background to Reform

The excellent economic growth that Malaysia enjoyed in the 1970s was interrupted in the early 1980s by severe turbulence in the international economic environment. A declining terms of trade and an increase in government expenditures in 1980-82 led to large fiscal and balance-of-payments deficits. The government

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implemented a policy of expenditure restraint to curb high interest rates and reverse the declining growth, but could not control investments of public enterprises.

In 1985, Malaysia experienced its worst growth performance in two decades with a fall in real GDP by 1.0 percent and a decline in manufacturing, construction, and trade output. Because the large budget deficits prevented the government from stimulating the economy through its own spending, it undertook a series of reforms, in 1986, in an attempt to revitalize growth. The majority of Malaysia's economic reform policies were aimed at promoting investment in the Malaysian economy (both domestic and foreign), and at privatization.

II. Evolution and Chronology of Malaysia's Economic Reform

1982-84

Government abandons its counter-cyclical fiscal policy as it faces deteriorating balance of payments and rising fiscal deficit.

Malaysia's tradition of trade surpluses is broken as the trade balance goes into deficit and there is a significant decline in the terms of trade.

Expenditure restraint policies are implemented to curb high interest rates and reverse decline in growth.

Restrictive monetary policy.

Investments of public enterprises continue to rise.

1985

Malaysia experiences its worst growth performance in two decades; GDP falls by 1.0 percent.

Adjustment policies are introduced:

Monetary policy is relaxed
Interest rates are reduced
New Investment Fund is established.

1986

Dr. Mahathir Mohamad's United Malays National Organization (UMNO) party is re-elected in the national election and he retains the office of prime minister.

The Fifth Malaysia Plan is published in March, completing the final phase of the outline perspective plan (1971-90).

An industrial master plan is prepared in collaboration with the U.N. Industrial Development Organization (Unido).

Terms of trade decline by 20 percent.

Foreign equity regulations are modified:

Proportion of foreign ownership now related to export content of the project; 100 percent foreign ownership permitted if the company exported 50 percent or more of output or employed 350 full-time Malaysian workers.

Anti-Recession Committee is formed to create employment and growth and improve the government accounts:

This results in a restoration of initial cutbacks proposed in the Fifth Plan development budget
Export Credit Refinancing (ECR) scheme is expanded allowing foreign firm participation.

Measures aimed at stimulating manufacturing exports and encouraging domestic businesses are announced:

Industrial Coordination Act (ICA) was liberalized— minimum paid-up capital requirement raised from $400,000 to $1 million
New Investment Fund (NIF) provided $250 million in low-cost funds to encourage new fixed investments.

Strong patent law passed.

Major privatization efforts undertaken:

Malaysian International Shipping Corporation (MISC) makes its shares available to the public
Kelang Container Terminal Sdn Bhd (KCT) becomes Malaysia's first major privatized company.

1987

MISC is listed on the Kuala Lumpur Stock Exchange (KLSE).

Introduction of new exchange control measures:

Ceiling on loans without permission for residents borrowing from non-residents raised from M$100,000 to M$1 million
Nonresident company specific exchange control approval required for loans exceeding M$10 million (previously M$500,000)
Export proceeds can be repatriated in any foreign currency (except South Africa's and Israel's).

New copyright law is passed.

1988

Provisions for foreign ownership extended to foreign companies exporting 20 percent of their output and to hotel and tourist projects.

1988 budget contains a nearly complete withdrawal of the sales tax exemption on virtually all foodstuffs.

National Economic Consultative Commission (NECC) is established to review the New Economic Policy (NEP) (1971-1990) and make recommendations on economic policy beyond 1990.

1989

Guidelines for new foreign projects licensed or approved are extended beyond 1990.

Deadline for use of capital tax allowance by foreign companies extended to January 1991.

1989 budget reduced corporate income taxes from 40 percent to 35 percent and began phasing out the 5 percent development tax over a 5-year period.

Sales tax exemption removed from additional high-value food products.

1990

National Electricity Board slated for privatization in January, although moves are delayed as the issue of foreign participation is debated.

In 1990 budget, 142 items obtained reductions in import duty, sales tax, surtax, and excise duties.

Gulf crisis presses Malaysia to increase its oil production; daily output is raised and part is earmarked for ASEAN countries.

Prime Minister Mahathir Mohamad resumes office after UMNO claimed victory in October elections:

Two new cabinet positions are created: Ministry of International Trade and Industry and Ministry of Domestic Trade and Consumer Affairs, representing a split of the Ministry of Trade and Industry's functions.

III. Analysis of the Reforms

A. Timing

- **The policy reforms were largely a reaction to the failed programs of the Fourth Malaysia Plan (1981-85).** Initially this plan followed a counter-cyclical fiscal policy to deal with declining terms of trade. This program consisted of large increases in spending and cuts in taxes in an effort to maintain domestic income levels. In the face of falling commodity prices for its exports, the country experienced large fiscal and balance-of-payments deficits, which were financed by massive international borrowing. The stimulative policies were then reversed. Austerity measures were adopted, spending was restrained, and monetary policy became restrictive. The impact of the stimulative program kept portions of the economy growing through 1984, but growth ended in 1985.

- **The stimulative aspects of the Fourth Malaysia Plan distorted the industrial sector of the economy.** The government's ambitious projects and a fiscally stimulated property boom created high levels of demand for local manufacturing and helped disguise this sector's competitive weakness internationally. The industrial growth of this period was rapid, inefficient, and costly. Capital equipment and purchased sub-assembly inputs grew faster than output while employment grew at a slower pace. The result was a decline in total productivity and a rise in unemployment.

- **It was finally Malaysia's decline in GDP growth in 1985 and its sluggish performance in 1986 that provided the impetus to policymakers for serious economic reforms.** With large budget deficits constraining expenditure, the government advanced to a

relaxation of controls on foreign and domestic investment, export promotion policies, and overall indirect support for growth. Malaysia's changes in economic strategy necessitated corresponding adjustments to the Fifth Malaysia Plan (1986-90).

B. Sequencing

- **The initial objectives of Malaysian policymakers were to neutralize the impact of fiscal policy, to improve government accounts, and to create employment and growth.** A drastic reversal in fiscal policy took place in the first half of 1986 which resulted in a turnaround by the end of the year. An Anti-Recession Committee was formed which launched the Special Low Cost Housing Program. In addition, M$2 billion was restored to the Fifth Malaysia Plan development budget.

- **The majority of the policies implemented in the reform period were aimed at stimulating foreign and domestic investment.** As an initial step the government modified foreign equity regulations. The permissible proportion of foreign ownership was tied to the export content of the project. This move was followed by a successive relaxation in previously existing legislation which was to have forced foreign firms to move to 70 percent Malaysian equity holding by 1990. In 1988, the export requirements for foreign ownership were greatly reduced and extended to hotels and tourist projects. Domestically, monetary policy became accommodative to assist in private investment's recovery. Existing programs were liberalized and new programs were developed to encourage new fixed investment and to stimulate small industry development.

- **Significant advances in privatization were made in Malaysia during the reform period.** In 1986 the Malaysian Shipping Corporation made its shares available to the public, and Kelang Container Terminal Sdn Bhd became Malaysia's first major private company. The Malaysian Airline System and the National Telecommunications Company have made progress in privatization through the offering of shares to the Malaysian public. The National Electricity board was slated for privatization in 1990.

- **To further stimulate investment, a loosening of exchange controls took place.** In 1987 the government raised the ceiling on permission-free loans from abroad for both resident and nonresident firms. In addition, there was liberalization in the repatriation of export proceeds.

- **In response to private sector criticism, tax rates were eventually reduced.** In 1989 corporate tax rates were reduced from 40 percent to 35 percent. A 5 percent development tax began a five-year phaseout from the income tax beginning in 1990. Also in 1990, 142 items obtained reductions in import duties, sales taxes, surtaxes, and excise duties.

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Structural Reform Matrix (SRM)
Worksheet for Malaysia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1985		Reform Period 1986-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	80%	7.2	80%	7.2
		Low and Uniform Tariff Barriers	6	80%	4.8	90%	5.4
		No Local Content Regulations	4	60%	2.4	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	80%	7.2	90%	8.1
		Minimal Exchange Controls	5	70%	3.5	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	80%	5.6	80%	5.6
		Minimal Preferential Interest Rates	1	70%	0.7	80%	0.8
		Equal Access to Capital	3	40%	1.2	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	90%	6.3	90%	6.3
		Minimal Subsidies	4	70%	2.8	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	40%	2.4	90%	5.4
		Reduced Marginal Tax Rate	2	50%	1.0	90%	1.8
		Equitable / Uniform Tax Collection	2	80%	1.6	80%	1.6
10	Privatization	Divest Nonstrategic SOE's	5	30%	1.5	80%	4.0
		Franchise Out State Services	2	40%	0.8	60%	1.2
		Simulated Privatization	3	40%	1.2	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	70%	4.2
		Proactive Promotion	1	40%	0.4	80%	0.8
2	Information	Free Flow of Market Information	2	80%	1.6	80%	1.6
16	Enabling Environment	Private Property Rights	9	70%	6.3	80%	7.2
		Efficient Gov. Administration	2	80%	1.6	80%	1.6
		Legal and Accounting System	2	80%	1.6	80%	1.6
		Infrastructure	3	70%	2.1	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	63.0	65.6	78.3	80.0

MALAYSIA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP (1980):	7.4	6.9	5.9	6.3	7.8	-1.0	1.2	5.3	8.7	8.5
By sector: Agriculture	1.3	4.9	6.5	-0.6	2.8	2.5	4.0	7.4	5.2	--
Industrial Activity	6.7	3.5	6.7	10.4	11.5	-3.4	4.7	6.5	12.8	--
Services	11.9	11.0	5.1	6.5	7.1	-0.6	-3.1	3.0	6.7	--
Per Cap. GNP-Current US $	1680	1890	1910	1900	2040	1970	1850	1830	1940	2110
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	27.29	27.33	26.88	26.97	28.73	25.23	28.19	28.52	28.82	29.11
Purchasing Index, US=100	55.31	54.02	53.94	54.43	54.28	50.72	54.20	53.18	51.62	52.05
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	11.60	12.92	14.61	15.64	16.24	14.10	12.18	12.01	14.60	--
Exports (fob (1980 prices)	12.94	12.90	14.65	16.94	19.09	19.94	21.68	23.19	25.27	--
Current Account	-0.29	-2.49	-3.60	-3.50	-1.67	-0.61	-0.12	2.64	1.82	-0.18
Capital Account	0.75	2.03	3.34	3.48	2.16	1.76	1.40	-1.45	-2.31	1.37
Changes in Reserves	-0.48	0.52	0.39	0.04	-0.34	-1.18	-1.14	-1.47	1.07	-1.26
External Debt	6.61	9.23	13.40	17.96	18.81	20.45	21.94	22.68	20.54	19.42
Interest Payments (on foreign debt)	0.25	0.35	0.54	0.67	1.32	1.48	1.41	1.48	1.50	1.52
Export Growth %	-3.1	-0.3	13.6	15.6	12.7	4.5	8.7	7.0	9.0	--
Terms of Trade % Change	0.6	-9.9	-5.2	3.9	6.4	-8.1	-21.8	9.2	-0.6	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MALAYSIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	6.7	9.7	5.8	3.7	3.9	0.3	0.7	0.9	2.0	2.8
Fiscal Deficit (-)/Surplus as a % of GDP	-6.0	-14.9	-16.1	-9.7	-6.5	--	-10.4	-7.5	--	--
Investment Share of GDP %	30.4	35.0	37.3	37.8	33.6	27.6	26.0	23.4	26.1	26.9
Savings Share of GDP %	32.9	28.8	28.6	32.1	35.5	32.7	32.1	37.3	36.4	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	102.0	111.0	119.0	125.0	135.0	131.0	--	--	--
Government Share in Economy %[2]	19.9	24.6	26.7	24.6	23.6	0.0	30.0	27.0	--	--
Gross New Investment (US mn$)	934.5	1265.2	1397.0	1261.0	797.0	695.0	489.0	423.0	719.0	1846.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

PHILIPPINES

Philippines

General Assessment of Reform

- **The Philippines, under the Corazon Aquino government, has made respectable gains toward structural economic reform.** The economy is more open, less regulated and steps have been taken toward reducing monopolies and the state's economic role. Debt-equity swaps have been instituted to attract foreign investment and reduce the foreign debt. Also, the currency is now fairly competitive. But overall reform progress has been uneven and not credibly sustained. The most significant gains were registered in the 1986-88 period, when Aquino first came to power and ambitiously set out to reform policy, management, institutions and the political culture. Since then, the reform drive has, in key respects, stalled and even regressed.

- **Corazon Aquino enjoyed enormous popularity at home and great respect abroad when she assumed power.** Universal resentment against the corrupt Ferdinand Marcos administration provided an important window of opportunity for reform of the government sector. Yet, while the popular mandate for sweeping change and reform was clear, entrenched interests in government and the business sector were predictably resistant to changes that threatened their privileged positions. In the end, there was no national consensus on economic policy among the key domestic stakeholders in the immediate post-Marcos period.

- **Numerous military coup attempts have greatly undermined Aquino's authority and political power.** The most damaging was the December 1989 uprising, which could have toppled the government had the U.S. government not intervened. Besides weakening the president's power, the military actions have also projected a negative, unstable image on the country, which has proved costly in terms in foregone foreign investment.

- **"Cronyism" and corruption are said to remain entrenched in the Philippines.** Aquino dismissed two cabinet ministers early in her administration for alleged profiteering. Yet, although it is not nearly as extensive and organized as it was during the Marcos regime (and Aquino herself is not considered to be personally involved), corruption is believed to remain widespread, if not more localized and sensational than before.

- **The economic results of Aquino's policies paint a mixed picture.** Real GDP growth has been around 5 percent on average since 1986--better than most developing countries undergoing reform but inferior to Singapore, Malaysia and Thailand. Spending has not been brought under control and as a result inflation has returned to double digits. Perhaps related to this price instability, overall savings and investment levels are very low. This suggests the need to accelerate export growth, which has remained an elusive goal for the government.

- **Foreign debt is the biggest obstacle to long-term recovery.** The Philippines is still one of the world's most heavily indebted countries. Total debt rose from $13 billion at the end of 1979 to over $29 billion at the end of 1988. Paris Club and commercial bank debt restructurings and an encouraging $1 billion debt buy-back in 1990 do not solve the long-term debt management problem.

- **The United States continues to play an active role in the economic and political life of the Philippines.** The United States was one of the first countries to offer aid at the beginning of the Aquino administration, and it is widely accepted that the government would not have survived without U.S. intervention in the 1989 coup attempt. Debate is still in progress over the fate of the U.S. military bases in the Philippines. A U.S. withdrawal, while doubtlessly boosting Philippine political and economic independence, could create uneasiness in the foreign investment community, at least in the short term.

- **The U.S. is not the only important external stakeholder, however.** The IMF and World Bank continue to play important roles in the restructuring process, in terms of both financial assistance and policy direction. The Japanese government is an increasingly important source of aid as well. Finally, non-U.S. foreign investment has been steadily on the rise, particularly from Japan, Hong Kong and Taiwan.

I. Background to Reform

The assassination of Benigno Aquino in 1983 prompted a flight of capital from the Philippines that precipitated a balance of payments crisis. The economy created under the Marcos government was heavily dependent on imports and foreign capital and did not adjust well to the external shocks of the early 1980s. After declaring a debt moratorium in 1983 and reaching a level of

inflation in 1984 of 50 percent, the Philippines entered into a stabilization program with the IMF.

Although the Marcos government was successful at carrying out the stringent IMF program, when Corzaon Aquino assumed the presidency in 1986, the Philippine economy was in a period of sharp decline. Poverty was widespread, and unemployment and external debt were growing. As her government endeavored to achieve short-run economic stabilization, it did not have the benefit of a transition period. It was able, however, to draw upon a group of University of the Philippines academics who had conducted a critical analysis of the Philippine economy in the latter years of the Marcos regime.

In 1986, this group rapidly prepared a set of policies for the new government that was thereafter referred to as the "yellow book." The recommendations and policies of the yellow book were basically market-oriented, conservative policies and had been advocated by the multilateral institutions and the United States. The yellow book became the basis for economic policy under the Aquino government.

II. Evolution and Chronology of the Philippines' Economic Reform

1981

Tariff reform and import liberalization program under the auspices of a World Bank structural adjustment loan (SAL).

1982

8.1 percent devaluation.

Reforms to simplify tax system and increase effectiveness of tax administration.

1983

21.4 percent devaluation in response to balance of payments crisis.

Assassination of Benigno Aquino.

1984

IMF stand-by agreement for SDR 615 million:

The peso is pressured to return to a managed float
$1.1 billion rescheduling of official development loans
Austerity measures announced.

1985

First of two commercial bank debt restructurings for a total of $15 billion.

1986

Corazon Aquino assumes the presidency in a tumultuous election which ends the Marcos regime.

President Aquino strives for democracy and seeks to reunite the country.

New Aquino government adopts the policy agenda outlined in the "yellow book" including:

Outward-oriented trade
Elimination of quotas on imports
Elimination of taxes on traditional exports
Avoidance of an overvalued exchange rate.

New IMF agreement for SDR 198 million in stand-by credits over 18 months, and SDR 224 million under compensatory finance facility.

Monopolistic interventions torn down:

Most agricultural export taxes are abolished
Ban on copra exports is ended
Special levy on fertilizer eliminated
Taxes on pesticides reduced
Coconut oil exports liberalized
Philippine Sugar Marketing Authority abolished, ending monopoly in sugar trading
Monopolies ended in coconut, livestock, and most fertilizer trading.

Major tax reform program implemented:

Taxes are raised on cigarettes and beer
Tax and duty exemptions are removed from publicly-owned corporations
A uniform corporate income tax rate is adopted with limitations on allowable deductions
Tax system is improved by converting excise taxes to an ad valorem basis, making tax rates more uniform and removing exemptions, and strengthening collections
Income taxes are eliminated altogether for families below the poverty line.

Government institutionalizes intentions for privatization which originated in the Marcos administration.

The Presidential Commission on Government Reorganization is created.

Commission to make recommendations for reforms of government corporations and public financial institutions:

125 government corporations were to be sold, 37 kept in current form, the remainder abolished, consolidated or converted to regular government status.

Policies adopted to rationalize and increase the transparency of government support for corporations.

Rationalization program adopted for two major government financial institutions with the assistance of the World Bank:

Nonperforming assets are disposed of by the Development Bank of the Philippines (DBP) and Philippine National Bank (PNB)
Government agrees to sell off six commercial banks it had acquired.

Trade liberalization begins with eventual goal of removing import licensing requirements on all 1,232 items and replacing them with tariffs of equal protective effect.

Debt for equity scheme introduced by administration in an effort to stimulate foreign investment.

1987

Paris Club agrees to $870 million rescheduling.

Commercial banks reschedule $9.6 billion.

The Philippines' new constitution is overwhelmingly approved.

President Aquino's candidates triumph in congressional elections.

Omnibus Investment Code is introduced with a set of investment incentives:

Replaces performance - based incentives (on net local content and net value added) with income tax holidays.

The most threatening in a series of military coup attempts comes close to overthrowing the government.

Results in a major shift toward right-wing policies and an agreement to meet military demands. President Aquino promises:

To enforce restrictions on trade union activity
A 60 percent increase in military pay
To denounce all communist organizations.

1988

Introduction of value-added tax of 10 percent to take the place of sales and excise taxes.

Import licensing liberalization completed on all 1,232 items.

1989

Memorandum of economic policy is addressed by the Government to the IMF with emphasis on:

Privatization of SOEs
Improved tax administration and new revenue measures
Financial sector reform
Expanded public investment
Continuation of trade liberalization program.

IMF approves $1.3 billion in extended fund and contingency facilities for 1989-91.

Philippines to receive $3.5 billion under the Multi-lateral Assistance Initiative (MAI):

Capital was intended to stimulate growth and was linked to specific policy reforms.

Executive Order No. 364 reduces the minimum 10 percent tariff rate to zero and also reduces tariffs on a selected number of raw materials and other non-locally available items.

Aquino regime faces the most threatening coup attempt to date:

US intervention saves the government.

1990

$1 billion debt buyback:

Funds provided by the IMF, World Bank and the Japanese and U.S. governments
Commercial banks pledge $700 million in fresh funds
Net effect is reduction in debt and cost of servicing.

Country is faced with first a drought and then a serious power shortage on the island of Luzon.

Administration addresses the issue of improving the country's infrastructure as disasters are illuminating its inefficiency.

Speculation surrounds the origins of a series of bomb explosions in Manila throughout the spring and summer.

Natural disasters continue with a devastating earthquake in July and typhoons and floods.

Gulf crisis raises the country's energy prices and causes a fall in workers' remittances from the Middle East, a major site of Filipino emigration:

Gas prices hiked 25 percent, but remain far below market levels.

Government fails to hit deficit targets.

IMF suspends support.

Congress considers new law allowing 100 percent foreign equity in firms serving the domestic market:

Existing limit is 40 percent foreign equity.

Cabinet approves a package of economic reforms in June including:

Abolition of price controls
Relaxation of foreign investment regulations
Deregulation of financial markets
Accelerated privatization
Restructuring of tax system
Import tariff reductions:
Four levels of duty, ranging from a minimum of 3 percent to a maximum of 10 percent (raw materials), 20 percent (intermediate goods), 30 percent (finished goods). Present maximum tariff is 50 percent.

Quantitative restrictions on imports will be phased out.

Reform package is in line with long-standing IMF and World Bank recommendations.

Discussions have begun on liberalization of the foreign exchange market.

III. Analysis of the Reforms

A. Timing

- **Economic reform in the Philippines was launched at a major turning point in the country's political history.** Corazon Aquino enjoyed widespread popularity as the first elected president after 13 years of authoritarian rule under President Ferdinand Marcos. However, in spite of the population's approval of Aquino, a new constitution, and her congressional candidates, the new government did not enjoy extended political stability. The military uprisings greatly undermined Aquino's leadership.

- **By the time the Aquino government came into office, the costs of the IMF stabilization program, launched under the Marcos regime in 1984, had already been paid.** The current account deficit had been reversed by 1986 and inflation had been reduced to only .8 percent after reaching an unprecedented 50 percent in 1984. Aquino, therefore, did not have to begin with an acutely austere stabilization phase. Yet, at the same time, her structural reform agenda was not without political costs and risks. Her attempts at liberalizing trade and privatizing state companies were in many respects effectively resisted.

- **The Philippines' external position at the onset of reform in 1986 was, for the first time in many years, extremely favorable.** A sharp fall in world oil prices in 1986 reduced petroleum imports by $580 million and a boom in coconut prices late in the year gave a boost to exports. The Aquino government was also the recipient of considerable international goodwill which translated into aid flows of $1.4 billion in 1986--twice their 1985 levels.

- **Much of the intellectual spadework for structural economic reform was already completed when Aquino came to power.** A

critical analysis of the Philippine economy, having been conducted by a group of academics from the University of the Philippines, was ready to be formulated into a policy agenda when Aquino was swept into office. This agenda, based on analysis which took place in the latter years of the Marcos regime, becomes known as the "yellow book," and its recommendations were the foundation for economic policy under the Aquino administration.

B. Sequencing

- **In line with the new government's goals of economic reform and recovery, its initial action was to quickly dismantle the monopolistic interventions of the Marcos regime.** A reform of the important agricultural sub-sectors was tackled first, as most export taxes were eliminated, a ban on copra exports was lifted, and monopolies in sugar and coconut trading were abolished. This was a decisive and politically astute move by the Aquino government to disassociate itself from the "crony" characteristics of the Marcos administration and demonstrate its commitment to a rural-based development strategy.

- **A method for raising revenues, improving the tax system and easing the taxation burden of the poor took the form of an extensive tax reform program that was implemented within the new government's first year of power.** This program was vital to meeting additional objectives of the Aquino government: curbing the fiscal deficit, establishing a more uniform tax collection system, and alleviating poverty. During the martial law government, large publicly owned corporations were exempt from taxes and duties. At the same time, the poor were burdened with a disproportionately heavy tax load.

- **The Aquino government undertook relatively easy to solve administrative measures when it first came to power.** Other problems, such as reform of public institutions, privatization, the burden of external debt, and trade liberalization presented considerably more difficulties. Apart from a rationalization program which successfully restructured the two major government financial institutions, progress has been slow in other reform areas.

- **Privatization, initially a fairly aggressive program, has been overrun with technical, bureaucratic and institutional obstacles, and is now a more scaled-down program.** A great deal of attention and thought from high levels of government went

into the creation of a broad policy framework for privatization. Yet, the state has divested very few companies. Difficulties in outright sale of large state companies, (e.g. Maricalum Mining Corporation), have forced the government to consider alternative approaches. One approach reportedly being considered is the use of the stock market to sell off part if not all of the targeted enterprises.

- **The latest reform package (June 1990) reflects the government's interest in pushing incremental reforms forward.** The IMF, for one, continues to require policy compliance in key areas such as price reform, trade liberalization and privatization. The internal impetus for reform, however, appears limited.

Structural Reform Matrix (SRM)
Worksheet for Philippines

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				Rating	Score	Rating	Score
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		Low and Uniform Tariff Barriers	6	60%	3.6	80%	4.8
		No Local Content Regulations	4	20%	0.8	90%	3.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	80%	7.2	80%	7.2
		Minimal Exchange Controls	5	30%	1.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	70%	4.9
		Minimal Preferential Interest Rates	1	20%	0.2	60%	0.6
		Equal Access to Capital	3	20%	0.6	50%	1.5
11	Prices and Wages	Limited Wage and Price Controls	7	60%	4.2	70%	4.9
		Minimal Subsidies	4	40%	1.6	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	60%	3.6	50%	3.0
		Reduced Marginal Tax Rate	2	20%	0.4	60%	1.2
		Equitable / Uniform Tax Collection	2	20%	0.4	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	30%	1.5
		Franchise Out State Services	2	20%	0.4	60%	1.2
		Simulated Privatization	3	20%	0.6	60%	1.8
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	50%	3.0
		Proactive Promotion	1	50%	0.5	70%	0.7
2	Information	Free Flow of Market Information	2	30%	0.6	60%	1.2
16	Enabling Environment	Private Property Rights	9	70%	6.3	70%	6.3
		Efficient Gov. Administration	2	30%	0.6	50%	1.0
		Legal and Accounting System	2	40%	0.8	70%	[illegible]
		Infrastructure	3	60%	1.8	40%	[illegible]
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	37.0	43.2	62.2	[illegible]

PHILIPPINES

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	5.0	3.4	1.9	1.3	-6.9	-4.4	1.9	5.8	6.7	5.7
By sector: Agriculture	4.9	3.8	3.3	-2.0	2.0	3.4	3.3	-1.0	3.6	--
Industrial Activity	4.7	4.8	2.0	0.8	-10.3	-10.2	-2.1	7.7	8.5	--
Services	6.1	3.0	3.6	3.2	-7.4	-4.3	2.9	6.6	6.7	--
Per Cap. GNP-Current US $	680	770	800	740	630	570	560	590	630	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	13.60	13.33	13.80	13.30	11.99	10.65	11.84	12.26	12.00	12.61
Purchasing Index, US=100	48.93	47.61	45.64	54.28	35.50	36.79	43.34	40.47	39.73	48.79
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	8.29	8.17	8.37	8.39	6.94	5.97	6.34	7.32	8.67	--
Exports (fob) (1980 prices)	5.79	6.20	6.04	5.63	5.75	5.54	5.97	5.89	6.40	--
Current Account	-1.92	-2.10	-3.21	-2.77	-1.29	-0.04	0.95	-0.44	-0.39	-1.47
Capital Account	2.81	1.53	2.48	-0.75	0.82	1.00	0.20	0.27	1.05	1.76
Changes in Reserves	-1.09	-0.19	0.62	1.91	-0.36	-0.04	1.34	0.10	-1.00	-0.46
External Debt	17.42	20.88	24.46	24.29	24.24	26.64	28.33	30.05	29.45	--
Interest Payments (on foreign debt)	0.38	0.53	0.55	0.66	0.92	0.94	1.14	1.43	1.64	1.91
Exports Growth %	15.4	7.1	-2.6	-6.7	2.0	-3.6	7.7	-1.3	8.7	--
Terms of Trade % Change	-15.9	-12.0	-2.7	4.4	-2.4	-6.6	6.6	10.1	11.8	-0.3

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

PHILIPPINES

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	18.2	13.1	10.2	10.0	50.3	23.1	0.8	3.8	8.8	10.6
Fiscal Deficit (-)/Surplus as a % of GDP	-1.3	-4.0	-4.2	-1.9	-1.8	-1.8	-4.9	-2.4	-2.8	..
Investment Share of GDP %	30.7	30.6	28.3	26.7	17.0	13.9	12.9	15.6	17.3	18.7
Savings Share of GDP %	25.0	25.1	21.6	19.9	16.9	16.9	19.1	16.4	17.8	..
Unemployment	4.8	5.4	5.5	5.4	6.2	7.1	6.7	9.5	8.5	..
Real Wage Index[1] 1980=100	100.0	103.0	104.0	127.0	110.0	107.0	118.0	..	..	..
Government Share in Economy %[2]	9.1	8.6	9.2	9.1	8.1	9.2	11.5	15/4	15.6	17.2
Gross New Foreign Investment (US mn$)	-106.7	172.2	16.0	105.0	9.0	12.0	127.0	307.0	936.0	482.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

SOUTH KOREA

SOUTH KOREA

General Assessment of Reform

- **Export-led growth has been at the heart of Korea's development strategy since the early 1960s, when the nation began issuing five-year development plans.** While each of these plans addressed specific conditions and set specific goals, a basic objective common to all plans, especially the first three, was export-oriented industrialization. This export-oriented growth strategy was supported by complementary macroeconomic policies throughout the 1960s and 1970s, and was implemented by a highly competent group of economists and bureaucrats.

- **Korea did not have to undergo a fundamental economic reorientation when it was hit by exogenous economic shocks in the late 1970s.** Unlike many other developing countries, Korea's industrial sector was already geared toward export markets when balance-of-payments problems developed. This made possible a generally smooth and relatively rapid process of stabilization, adjustment and recovery. Korea's consistently competitive exchange rate policy helped keep domestic producers efficient, the external sector strong, and the domestic economy booming for much of the decade.

- **Korea has benefited greatly from its historical trade and investment ties with Japan and the U.S.** These two countries have been important export markets for Korea, as well as rich sources of capital and technology. The U.S., in particular, provided important military and economic assistance to Korea in the 1950s.

- **Korea's approach to structural economic reform has been tepid, notwithstanding its obvious macroeconomic success in the 1980s.** Authorities have not aggressively sought to open up the domestic market to imports and foreign investment. Agriculture, in particular, remains an extremely protected sector. Also, some liberalization measures, such as intellectual property protection, have been unevenly applied.

- **Pragmatism has clearly been a guiding principle in Korean economic reform.** The discipline of the marketplace has been useful to policymakers inasmuch as it has fostered the development of a robust, export-driven economy. At the same

time, officials have failed to take the initiative in other important reform areas. Many actions, particularly in the trade liberalization and foreign investment areas, were effectively forced by strong threats from abroad. Subsequent actions on the part of Korean authorities have frequently been considered half-hearted and inadequate by its trading partners.

- **The reform process, by promoting privatization and the like, has attenuated the state's role in the economy.** But the Korean government remains highly interventionist and resistant to more sweeping changes that would allow a freer interplay of market forces in the domestic economy. One explanation for this resistance is that a more radical structural reform effort lacks a domestic constituency. Powerful industrial groups would resist, for example, the higher borrowing costs that might accompany the liberalization of interest rates; so might consumers and laborers if such moves meant a loss in purchasing power. Korea's farm sector has already registered its opposition to moves that would open up the agricultural sector to foreign competition.

- **Korean policymakers face significant redistributive issues.** The nation's growing prosperity and real income gains mask widening income inequalities between rural and urban workers and between the urban poor and urban middle sectors. The nation's political liberalization will strengthen these groups and empower their demands for greater economic equality. In the process, the government is likely to be called upon to play an even stronger role in directing the economy.

I. Background to Reform

Korea's industrial transformation was achieved through a succession of "Five-Year Economic Develcpment Plans," initiated in 1962. These plans laid the groundwork for the re-direction of the Korean economy toward export-led growth and the de-emphasis of import substitution policies. This policy shift was undertaken in response to changing economic conditions evident in the late 1950s. By 1960, Korea's import-substitution strategy had achieved a measure of self-sufficiency with respect to most nondurable consumer goods. Also, most post Korean War war construction projects had been completed. It also was clear to policymakers that the domestic market was too small to allow sustained growth through further import-substitution. Most importantly, there was

inadequate capital available to finance the development of capital goods industries.

Although Korea's economic transformation began in the 1960s, it was only in the 1980s that the nation began to undertake structural reforms to reorient its economy toward market principles. Reform was precipitated by a series of external and internal shocks which converged upon the nation in the late 1970s. Macroeconomic stabilization measures were begun in mid-1978, but were interrupted by the assassination of President Park in 1979. The seeds of a more substantial, comprehensive reform effort can be seen in the early 1980 implementation of an economic adjustment program that evolved into a broader market liberalization effort over the course of the decade. Thus, Korea's structural reform period is considered to be the decade of the 1980s.

II. Evolution and Chronology of South Korea's Economic Reform

1960-69

Six specialized banks are instituted, including the Korea Exchange Bank and the Korea Housing Bank.

Capital Market Promotion Law enacted and Korea Investment Corporation created:

Intended to underwrite and promote sales of government securities to the public.

Public Ownership Inducement Law passed:

Encouraged large companies to open up their ownership to the public.

1964

Korea moves from a fixed parity to a unitary floating exchange rate system.

Devaluation of the won by 64 percent.

1970-79

33 foreign bank branches open for business in Korea.

Number of commercial banks in the country doubles to 10.

201

1971-72
Devaluation of the won by 12 percent.

1975
Devaluation of the won by 19 percent.

1980-82
Devaluation of the won and the adoption of a "controlled float" exchange rate regime.

A freeze on government salaries and establishment of guidelines for wage increases.

Adoption of fiscal policies to stimulate demand and to reduce public-sector deficits.

Between March 1980 and February 1982 IMF furnishes two 1-year standby arrangements.

Enactment of the Anti-Monopoly and Fair Trade Act of 1981 and establishment of the Fair Trade Administration within the Economic Planning Board.

The lowering of effective tariff rates to 7 percent.

The introduction of a far-reaching tax reform including:

- Increased tax for interest and dividend income
- Simplified corporate tax structure
- Extended value-added tax (1981)
- Reduced individual income tax rates
- Increased deductions for wage and salary earners and spouses (1982).

The elimination of preferential interest rates and the reduction of directed loans in 1982.

A lowering of entry barriers for foreign banks.

A relaxation of entry barriers to the Korean Stock Market for foreign firms.

The adjustment of the tax structure, greater scrutiny of real estate transactions, and the passage of laws that require full disclosure of real estate holdings.

The removal of import restrictions on a large number of items, raising the import liberalization ratio from 69 percent to 77 percent.

1983

The appreciation of the won by 7 percent in real terms.

The creation of Boards of Directors within public enterprises to supervise operations.

A steady reduction in the government procurement price for rice during 1983-84.

The tightening of fiscal policy in 1983; an increase in revenues mainly through higher indirect taxes; a 5 percent tariff on imported oil; a cut in government spending.

The enactment of the Basic Law for Management of Government Invested Enterprises (GIE) to increase efficiency and allow more GIE operational autonomy.

IMF supports adjustment plans with two more 1-year standby arrangements between July 1983 and March 1985.

1984

A gradual reduction in government subsidies to farmers and a freeze on government spending at 1983 levels.

The adoption of a five-year import liberalization plan intended to:

Raise the import liberalization ratio to 85 percent by 1984
Remove 540 items from the negative list effective 1985-86.

Introduction of a system granting automatic approval for foreign investment.

The announcement of a five-year tariff reduction program: a reduction of the average tariff rate from 24 percent in 1984 to 18 percent by 1988.

The deregulation of most lending rates and deposit rates for instruments with maturity of over two years, and the introduction of a narrow range (10-10.5 percent) within which banks are permitted to charge different interest rates without government approval.

A ban on beef imports except for use in tourist hotels.

1987

Foreign Trade Act passed.

Establishes commission to determine whether particular imports are damaging to domestic industries.

Establishment of the Public Enterprise Privatization Committee, which targeted some 11 state companies for privatization.

Korea signs three trade and investment agreements with the U.S.:

Korea promises to eliminate, over three years, structural barriers to trade and investment
Agreement also calls for further liberalization of agricultural imports.

Replacing a ban on imported beef with a quota system.

26 manufacturing industries removed from foreign investment "negative list."

Foreigners allowed to buy convertible bonds for first time.

Removed approval process for invisible trade payments.

The opening of domestic markets to chocolates, cigarettes, advertising, insurance, and motion pictures.

The passage of laws that protect intellectual property rights.

The appreciation of the won by 8.7 percent.

Elections are held on December 16.

Democratic Justice Party (DJP) triumphs over the divided New Korea Democratic Party (NKDP).

1988

President Roh Tae-woo is sworn in in February.

The appreciation of the won by 15.8 percent to reduce the trade imbalance.

A reduction of levies on luxury items.

The sale of the government stake in Pohang Iron & Steel.

The appointment of a new economic cabinet and the announcement of new policy direction:

Gentle appreciation of the won
A gradual further opening of the Korean market
Higher domestic consumption
Less reliance on exports for economic growth
More welfare spending.

The liberalization of the commercial paper market and relaxation of regulations on corporate financing.

The announcement of a revised plan for liberalization of the capital market between 1989 and 1992 that would allow direct foreign investment in the Korea Stock Exchange by 1992.

Start of deregulation of interest rates:

Deposit rates and government fund rates remain subject to controls.

1989

The lowering of the central bank discount rate.

The announcement of another five-year tariff reduction plan that would lower the average rate to 7 percent by 1993.

1990

The appointment of a new economic cabinet team in March 1990. The new cabinet canceled the proposed financial reform plan that would have required the use of real names in financial transactions.

The adoption of the market-exchange rate system in March 1990.

Announcement of the adoption of a free-floating exchange rate system after 1992.

Announcement of plans to rationalize the income tax structure.

September 4: South Korea's prime minister, Mr. Kang Youn-hoon, meets with North Korea's Mr. Yon Hyong-muk, after 18 years of negotiations for a meeting.

III. Analysis of the Reforms

A. Timing

- **Korea's economic reform efforts were initially undertaken in response to crisis economic conditions resulting from external shocks.** Korea was ill-equipped to manage the twin shocks of skyrocketing oil prices and international interest rates that converged upon the nation in the late-1970s. In 1979, Korea's current account deficit soared fourfold, to $4 billion. Meanwhile, inflation soared as a result of a sharp rise in fuel costs, higher grain import prices, an increase in government subsidies and large wage increases. The government's attempts to curb inflation through price controls spurred supply shortages and fueled the black market. By the turn of the decade, Korea's negative growth, rising inflation and a yawning current account deficit reached crisis dimensions.

- **Korea's first attempt at economic stabilization in the late 1970s was interrupted by a political crisis.** The macroeconomic stabilization measures begun in 1978 were cut short by the Park assassination in 1979.

- **Poor public enterprise performance in the late 1970s and early 1980s spurred state company reform efforts.** This took the form of the 1983 Basic Law for the Management of Government-Invested Enterprises (GIE), requiring Boards of Directors for each enterprise to manage operation of the enterprise. Although government officials sat on these boards, direct government intervention in the daily operation of these enterprises was significantly reduced. The Korean government accelerated the privatization of GIEs with the formation of the Public Enterprise Privatization Committee in 1987. The Committee chose 11 GIEs for total or partial divestiture. Pohang Iron and Steel Company, for example, went public in 1988.

- **The government's announcement of a timetable for import liberalization came about only after Korea's had achieved balance-of-payments stability.** By 1984, Korea's current account deficit had fallen to a manageable $1.4 billion, which was covered by capital inflows of almost $2 billion. By the following year, the current account deficit was less than $1 billion, and by 1986 Korea was enjoying an impressive $4.6 billion trade current account surplus.

- **Economic liberalization during the late 1980s was prompted by political reforms (1987-88) and by trade frictions with a major trade partner.** The new deputy prime minister and head of the Economic Planning Board during 1988-89 pressed for a gentle appreciation of the won and a gradual opening of the Korean market to imports still being restricted. This marked a policy movement toward higher domestic consumption, less reliance on growth through exports and more welfare spending. These efforts, however, were undermined by poor economic results, which led to the minister's departure. U.S. pressure on Korea mandated by tough U.S. trade legislation passed in 1988 ("Super 301"), has clearly also been a major impetus for Korean trade and investment reform. Bilateral talks in 1989 resulted in three agreements on trade and investment.

B. Sequencing

- **Stabilization and recovery were the government's top priority in the early reform period.** Between 1980 and 1981, officials were mainly concerned with stabilizing the external sector and restoring economic growth. Drastic liberalization measures were not attempted, although select reforms were undertaken toward the latter part of this phase. Stability was attained through exchange rate adjustments, which restored export competitiveness, as well as reduced import demand. An expansionary fiscal policy helped stimulate domestic demand and restore overall growth.

- **Liberalization began when recovery was at hand.** To dampen inflationary pressures, officials tightened fiscal policy and initiated a tax reform program. Select subsidies were cut and interest rates were permitted to rise to positive real levels. Preferential interest rates for priority sectors were eliminated. Trade liberalization was undertaken and select import restrictions were eased. Foreign investment rules were liberalized.

- **A second liberalization phase took shape in 1985-86 under favorable world economic conditions.** Helped by an increasingly strong balance-of-payments position and sturdy economic expansion, the Korean government consolidated earlier reforms in the trade and foreign exchange areas and took steps to liberalize domestic markets, particularly financial markets.

- **Privatization, trade, and investment liberalization accompanied Korea's political reform period (1987-89).** This was a turbulent policy period. The democratic election of Roh Tae Woo as president and his appointment of Cho Soon to the nation's top economic post represented, to some extent, a relative de-emphasis of Korea's export-first policies. Many state enterprises were privatized during this period, and market liberalization policies related to foreign investment were instituted. But Cho's policies lacked the support of the newly empowered parliament, which was dominated by the opposition. Ultimately, he did not have the support of the president, who sacked Cho when export growth began sagging and inflation started rising in 1989. The new team made clear its intention of re-emphasizing export-led growth.

Structural Reform Index (SRI)
Worksheet for South Korea

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1975-1979		Reform Period 1980-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	60%	5.4
		Low and Uniform Tariff Barriers	6	50%	3.0	70%	4.2
		No Local Content Regulations	4	70%	2.8	80%	3.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	80%	7.2
		Minimal Exchange Controls	5	40%	2.0	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	20%	1.4	60%	4.2
		Minimal Preferential Interest Rates	1	10%	0.1	90%	0.9
		Equal Access to Capital	3	20%	0.6	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	60%	4.2
		Minimal Subsidies	4	20%	0.8	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	80%	4.8	90%	5.4
		Reduced Marginal Tax Rate	2	40%	0.8	60%	1.2
		Equitable / Uniform Tax Collection	2	40%	0.8	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	80%	4.0
		Franchise Out State Services	2	30%	0.6	50%	1.0
		Simulated Privatization	3	30%	0.9	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	40%	2.4	70%	4.2
		Proactive Promotion	1	30%	0.3	50%	0.5
2	Information	Free Flow of Market Information	2	30%	0.6	60%	1.2
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2
		Efficient Gov. Administration	2	60%	1.2	80%	1.6
		Legal and Accounting System	2	40%	0.8	60%	1.2
		Infrastructure	3	60%	1.8	90%	2.7
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	38.7	40.9	70.4	71.9

SOUTH KOREA

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT															
Real % Change in GDP:	6.5	13.2	10.9	10.9	7.4	-3.0	7.4	5.7	10.9	8.6	6.9	12.4	11.8	11.3	6.1
By sector: Agriculture	4.2	10.2	3.0	-9.9	7.4	-19.9	14.3	7.4	7.7	-1.5	3.8	4.6	-6.8	9.0	--
Industrial Activity	12.0	20.1	17.0	21.7	8.3	-0.8	6.7	8.2	16.9	15.0	6.9	16.1	16.5	11.7	--
Services	6.5	10.4	10.7	12.7	6.7	1.5	4.5	6.5	8.9	8.1	7.9	11.2	12.3	11.4	--
Per Cap. GNP-Current US $	580	750	910	1190	1510	1630	1830	1930	2100	2230	2310	2550	2920	3550	--
PURCHASING POWER PARITY COMPARISON															
Income Index, US=100	17.83	19.10	20.01	21.58	22.80	20.77	20.92	22.22	23.46	23.63	23.26	23.59	23.80	24.00	24.19
Purchasing Index, US=100	50.64	54.78	59.95	68.72	73.64	69.37	68.33	63.81	59.33	57.15	53.45	65.32	63.31	65.22	66.13
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)															
Imports (cif) (1980 prices)	13.4	15.6	17.9	22.2	24.6	22.2	25.9	25.8	28.6	33.8	35.3	88.4	42.4	50.5	--
Exports (fob) (1980 prices)	8.2	11.0	14.1	16.0	15.9	17.5	20.8	22.3	25.7	30.4	32.4	37.8	47.3	53.4	--
Current Account	-1.9	-0.3	0.0	-1.1	-4.1	-5.3	-4.6	-2.6	-1.6	-1.4	-0.8	4.6	9.8	14.1	5.1
Capital Account	2.3	1.6	1.4	1.8	5.0	5.6	4.3	2.7	1/4	1.9	1.1	-4.5	-7.7	-4.8	--
Changes in Reserves	-0.4	-1.3	-1.4	-0.7	-0.9	-0.4	0.2	-0.1	0.2	-0.5	-0.2	-0.2	-2.3	-3.7	--
External Debt	7.2	10.3	12.8	17.6	19.2	29.7	33.4	37.8	40.9	42.1	47.2	47.7	40.5	37.0	33.7
Interest Payments (on foreign debt)	0.3	0.4	0.5	0.7	0.9	1.3	1.7	1.9	2.5	2.8	2.9	2.4	2.1	1.9	1.7
Export Growth %	12.3	34.1	28.2	13.5	-0.6	10.1	18.9	7.2	15.2	18.3	6.6	16.7	25.1	12.9	--
Terms of Trade % Change	-9.7	14.1	7.0	4.8	-2.1	-13.3	-2.1	4.3	-4.7	2.2	0.5	8.8	2.4	2.8	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

SOUTH KOREA

OTHER KEY INDICATORS	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	25.3	15.3	10.2	14.5	18.3	28.7	21.3	7.3	3.4	2.3	2.5	2.8	3.0	7.1	5.7
Fiscal Deficit (-)/Surplus as a % of GDP	-1.97	-1.37	-1.75	-1.23	-1.74	-2.23	-3.34	-3.04	-1.04	-1.16	-1.17	-0.9	0.44	1.6	--
Investment Share of GDP %	27.1	25.3	27.3	31.4	35.5	31.1	29.1	27.4	28.8	29.8	29.3	28.3	29.5	30.6	34.5
Savings Share of GDP %	17.0	22.8	26.0	27.2	26.7	20.0	19.7	20.7	25.1	26.6	27.1	31.4	35.3	37.5	36.4
Unemployment %	4.1	3.9	3.8	3.2	3.8	5.2	4.5	4.4	4.1	3.8	4.0	3.8	3.1	2.5	2.8
Real Wage Index[1] 1980=100	60.0	66.5	78.0	94.3	104.0	100.0	98.3	102.8	109.0	124.2	125.9	--	--	--	--
Government Share in Economy %[2]	15.9	16.6	15.8	15.8	17.0	17.9	23.2	21.4	19.5	17.9	17.4	16.9	16.6	18.1	--
Gross New Foreign Investment (US mn$)	61.0	88.0	93.0	82.0	34.0	8.0	101.0	69.0	69.0	110.0	234.0	435.0	601.0	871.0	758.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

SRI LANKA

Prepared for the Center for International Private Enterprise

SRI LANKA

General Assessment of Reform

- **Sri Lanka was a relatively early convert to market-based economic reform.** In 1977, when the nation first embarked on a wide-ranging economic restructuring program, most other developing country governments were still engaged in high degrees of enterprise regulation and market intervention. Sri Lanka had made important policy improvements in key economic areas by the time it entered a second adjustment and reform phase in 1986.

- **The 1977 reforms failed, however, to significantly reduce the size or scope of the public sector.** In fact, soon afterwards the government engaged in a massive public-investment program, which resulted in extremely large fiscal deficits in the early 1980s. The deficit contributed to other serious imbalances, including an overvalued exchange rate, which in turn led to a current account deficit the equivalence of 16 percent of GDP in the 1980-82 period. Sri Lanka's experience suggests the critical importance of fiscal policy in determining the overall success of structural reform efforts.

- **Sri Lanka's 1986-90 reform effort has been undermined by violence, terrorism and civil war.** Yet, to its credit, Sri Lanka has managed to sustain the general reform movement, however inconsistent and uneven policy implementation has been. The outlook for continued reform is highly uncertain, for when peace is restored to the country, ethnic and religious rivalries and animosities are apt to continue to harm possibilities for a unified, consensus-based approach to economic reform.

- **Sri Lanka is widely credited with having established progressive social institutions. Yet, its social welfare programs have been a heavy drain on the public sector.** In the 1970s, food subsidies alone consumed as much as 5-6 percent of GDP. Also, some international organizations have criticized certain programs (e.g., food and transportation subsidies) as being poorly targeted and inefficient.

- **Remarkably, the Sri Lankan economy continued to develop and respond to incentives through the late 1980s.** Civil disturbances did not completely set the economy back. Tourism, light manufacturing, and tea production fared relatively well and new products and export markets continued to open up. Annual GDP

growth fell but stayed at about 2-3 percent in the 1986-89 period.

- **Sri Lanka could realize vigorous economic growth if political order is restored and sustained.** In the late 1980s, civil unrest on the island kept tourism, exports and foreign investment well below their potential. In addition, high defense spending exerted significant strains on the national budget. In 1988, the defense sector's share of the national budget deficit amounted to 4 percent of GDP. Structural reforms implemented to date have laid the groundwork for potentially strong market growth. An expanding economy would go a long way toward reducing social and political discontent.

- **IMF and World Bank funding have guided the reform process, particularly in the last three years.** Sri Lanka has also been the beneficiary of concessional aid funding from donor nations. A three-year (1988-91) structural adjustment loan will keep Sri Lanka under IMF scrutiny through 1991. However, the nation's persistently high fiscal deficits threaten a cutoff in Fund support.

I. Background to Reform

Under new political leadership, Sri Lanka began market-based reforms in 1977. While liberalization policies remarkably improved economic performance and led to major efficiency gains, they failed to correct structural restraints to growth. The deteriorating economic situation was not addressed until a three-year, IMF-backed stabilization program was introduced in 1986. This program included a gradual reduction of public expenditures and the adoption of a more flexible exchange rate.

The positive results that were achieved in 1987 (liberalization of the trade regime, a devaluation of the exchange rate and a reduction in macroeconomic imbalances) evolved into a broader economic liberalization program. In 1988, recommendations from three high-level presidential committees led to the development of a policy framework paper (PFP) covering 1988-90. The key elements of the structural reforms envisaged in the PFP are public expenditure restructuring, civil service and public enterprise reforms, and a reform of the country's industrial policies to a more market-based orientation.

Sri Lanka's complex ethnic makeup has plagued its politics since independence in 1948. Successive conflicts have arisen

between the majority Sinhalese (who account for almost three-quarters of the population) and the next largest ethnic group, the Sri Lankan Tamils. The Tamils, who played an important pre-independence role in political life, have not been complacent about the Sinhalese's post-independence dominance. A radical nationalist faction of the Sinhalese is known as the JVP (People's Liberation Front), who, along with the Tamils, have participated in violent uprisings. The civil war in 1983 and recent outbreaks of unrest and violence have had severe negative effects on the country's economy.

II. Evolution and Chronology of Sri Lanka's Economic Reform

1977

J. R. Jayewardene and the United National Party (UNP) win landslide victory in country elections.

New constitution introduces a presidential form of government; powers of prime minister and cabinet are reduced.

Introduction of policy package aimed at opening and liberalizing Sri Lanka's economy:

Government begins process of exchange rate reform, import liberalization, abolishment of price controls and reduction of public sector monopolies.

1978

First five-year development plan (1978-83) includes an ambitious and massive public investment program.

1982

Referendum extends Mr. Jayewardene's presidency to a second term and also extends the life of the Parliament elected in 1977 to August 1989.

1983

An outbreak of ethnic conflict between the majority Sinhalese and the Sri Lankan Tamils escalates into civil war.

1986

The Sri Lankan government announces a three-year stabilization program:

Gradual reduction in public expenditures
More flexible exchange rate is adopted

Substantial liberalization of the trade regime
Maximum tariff rate reduced to 60 percent
Minimum tariff rate raised to 5 percent.

1988

Sri Lanka begins three-year, SDR 156 million, structural adjustment agreement with the IMF.

Introduction of policy framework paper (PFP) that sets the objectives of the three-year stabilization program and involves three major structural reforms:

1. Reorganization of Central government involving a streamlining of the government administrative structure, a reduction of the number of ministries to one-half, and a 25 percent reduction in the number of civil servants.

2. Major changes in industrial policies to accelerate industrial growth and increase the export orientation of the manufacturing sector including:

   Commitment to an exchange rate policy that would ensure the competitiveness of Sri Lanka's exports
   Tariff reforms directed at reducing effective protection and simplifying the tariff system.

   Objectives of privatization and phased program announced:

   Divestiture of State Distilleries, United Motors, and Ceylon Oxygen
   The entry of private enterprise into insurance and telecommunications sectors
   Annual targets set for additional privatization of government business undertakings.

   16 public manufacturing enterprises selected for transformation into public liability companies
   Rehabilitation programs established for indebted corporations-Air Lanka and Ceylon Shipping.

3. Restructuring of public expenditures; an elimination of wasteful expenditure programs and increasing the efficiency of the remaining programs.

Strict monetary policies emphasized to eliminate excess liquidity in the economy.

Open market operations introduced and market forces allowed to determine treasury bill interest rates:

- Intensified sales of treasury bills to non-Central bank sources
- Establishment of a re-purchase market for treasury bills
- Issue of Central Bank securities.

Public-sector policies to improve revenue efficiency:

- Minor export taxes abolished
- Specific taxes on tea reduced
- Specific administrative reforms implemented to improve BTT/excise tax collections.

The share of public expenditures in GDP is reduced by the reduction of transfers to corporations.

Significant export promotion policies are introduced:

- Export taxes on minor agricultural and marine exports are abolished
- Most export licensing and prior approval procedures are abolished
- Liberalization of gem industry
- Establishment of duty-free access to imported inputs and tax rebates for indirect exporters
- Adequacy of export financing facilities reviewed and short-term financing procedures improved
- Export floor price scheme and associated prior approval is abolished.

Tariff and licensing reform policies:

- Four-band tariff system introduced and maximum tariff rate lowered to 50 percent
- Import-licensing requirements eliminated except for security, health or environmental purposes.

Civil unrest severely disrupts economic activity and civil administration and decisively prevents any progress in reform policies by the end of the year:

- Terrorist activity halts production, exports, and tax collection
- Increased expenditures in defense, the public sector and social programs expand the fiscal deficit

Sri Lanka's external position deteriorates as tourism, foreign investment and exports are all negatively affected.

December 19 elections give United National Party a narrow victory— Ranasinghe Premadasa retains presidency.

1989

Government postpones needed fiscal and balance-of-payments adjustments:

Only minor price hikes implemented.

New government resumes reform process interrupted in 1988 and continues commitment to established policies.

By midyear, government recognizes need for new stabilization measures.

In order to contain public expenditures, subsidies are reduced for fertilizer, wheat flour, and rice.

Devaluation is accelerated.

Restrictive monetary policy:

To reduce excess liquidity in the economy: reduction of the proportion of outstanding treasury bills held by the Central Bank
Improvement of institutional framework for monetary intervention.

Reforms announced to improve the efficiency of the civil administration and reduce its cost to the government:

The closing of five public administration departments and retrenchment of staff from others
Assessment of civil service staffing needs and budget
Reduction of government expenditures via reform of the Janasaviya Program.

Privatization of three public enterprises continued; 18 PMEs converted to public liability companies as first step toward privatization.

Measures to encourage private sector investment:

Restrictions on foreign equity participation, except for reserved areas, eliminated
100 percent tax on transfers of equity shares to foreigners eliminated
Free transfer of quotas with respect to EEC and USA markets permitted
Special incentives that were granted to the handloom sector in 1988 eliminated
High-level committee established to streamline bureaucratic processes.

Working group is established in the financial sector to investigate ways to reduce intermediation costs and improve credit delivery.

The Indian Peace Keeping Force leaves Sri Lanka, including the North East Province; the Tigers move into this area and take over local government, tax collections, and assume some police duties.

The JVP continue to carry out terrorist activities in the south, a continuing impediment to the economy.

Government estimates damage to the economy from violence in 1989 at SLRs 10 billion ($277 million).

1990

Violence in the south subsides.

Country's preoccupation with JVP insurgency and its aftermath enables the government to implement the unpopular but much needed reforms backed by the IMF:

Price subsidies are removed
Devaluation of the currency
Paring down of the public sector via staff reductions.

Government announces a new industrial policy, with aims to diversify the economy, improve balance of payments, and shift emphasis from import substitution to export promotion:

Promote products in which Sri Lanka has a comparative advantage
Create a competitive advantage through deregulation
Encourage domestic savings

Promote domestic and foreign investment
Assist in infrastructure development, management improvements, productivity increases, and cost cutting
Develop linkages between large and small firms.

Import tariff structure is simplified; existing 19 tariff bands reduced to four:

Rates range from 50 percent on finished products to 5 percent for raw materials and capital goods.

Seven additional state corporations scheduled for conversion to state-owned companies, with privatization to follow.

Central Bank tightens enforcement of foreign exchange controls.

In line with the 1989-92 policy framework, the Sri Lankan government planned the following reform measures for 1990:

Tax Reform:

Discontinuation of income tax holidays, exemption on import taxes on capital goods and raw materials for projects catering to the domestic market
Increase the BTT rates and introduce a value-added tax.

Administrative Reform:

Reduction of staffing in the public sector.

Public Enterprise Reform:

Plan to attract foreign investment in the cement industry
Convert the telecommunications department into a public corporation and then a public liability company.

Agricultural Sector Reform:

Eliminate fertilizer subsidy.

Civil war continues over the Tamil Tigers hold of the Jaffna peninsula; fighting escalates in the second half of the year:

Budget for defense spending will increase by 50 percent
Defense will account for 16 percent of government expenditure.

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Persian Gulf crisis impacts Sri Lanka:

Rising unemployment as 100,000 migrant workers return from Kuwait
20 percent of the export market for tea is lost as a result of economic sanctions against Iraq
World Bank-sponsored Sri Lanka consortium pledges $1 billion in aid for fiscal 1991
Second round of major anti-poverty program gets under way.

III. Analysis of the Reforms

A. Timing

- **Political and civil unrest prevented the newly reelected Premadasa government from taking decisive action to correct serious fiscal and balance-of-payments imbalances that were pressing by late 1988.** Other than adjustment in the price of oil in early 1989, corrective measures were not taken until late that year.

- **At the same time, the country's preoccupation with the JVP insurgency may have facilitated reform implementation once the government acted.** It is notable that, in contrast to past austerity programs, massive strikes and protests did not accompany, for example, sharp price hikes for basic consumer goods such as bread, milk and sugar, which shot up by 30-50 percent during a two- month period in 1990.

- **In 1990, unfavorable external conditions added new complications to the government's adjustment efforts.** As a result of the Persian Gulf crisis, Sri Lanka was affected by the oil price shock. The nation also experienced the sudden return of an estimated 100,000 migrant workers from Kuwait. Also, Sri Lanka lost 20 percent of its tea export market as a result of the international trade embargo against Iraq.

B. Sequencing

- **The Sri Lankan economy benefited from a previous reform effort when adjustment was again required in 1986.** The 1977 reforms helped open up and liberalize the economy and to some extent the 1986-90 reform effort was built on these gains. In key areas, however, the Sri Lankan economy remains tightly controlled and restricted. In the trade area, for example, import restrictions

were more rational after 1977, but effective protection remained high.

- **Sri Lanka's reform effort began with a clear-cut stabilization period (1986-87), the main focus of which was the external sector, not fiscal policy.** A major priority of the 1988 PFP was correcting underlying fiscal imbalances, but fiscal reform policies were unevenly pursued and the deficit remained dangerously high. To revive growth and boost sagging investment, foreign investment rules were liberalized and tax relief measures were passed in 1989-90. There is evidence that Sri Lanka made progress toward improving the efficiency of the state sector during this period, but the overall fiscal reform effort has not been successful.

- **The existence of newly created public spending programs complicated the government's fiscal goals under the PFP in 1989.** Two particularly burdensome items were the Jana Saviya anti-poverty program and a school lunch project. In addition to being immensely expensive, critics charged that these two programs were poorly targeted.

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1987		Reform Period 1988-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	70%	6.3	80%	7.2
		Low and Uniform Tariff Barriers	6	30%	1.8	60%	3.6
		No Local Content Regulations	4	70%	2.8	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	60%	5.4
		Minimal Exchange Controls	5	60%	3.0	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	90%	6.3	90%	6.3
		Minimal Preferential Interest Rates	1	70%	0.7	70%	0.7
		Equal Access to Capital	3	50%	1.5	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	90%	6.3	90%	6.3
		Minimal Subsidies	4	40%	1.6	60%	2.4
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	40%	2.4
		Reduced Marginal Tax Rate	2	50%	1.0	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	50%	2.5
		Franchise Out State Services	2	30%	0.6	50%	1.0
		Simulated Privatization	3	20%	0.6	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	70%	4.2
		Proactive Promotion	1	50%	0.5	70%	0.7
2	Information	Free Flow of Market Information	2	50%	1.0	50%	1.0
16	Enabling Environment	Private Property Rights	9	70%	6.3	70%	6.3
		Efficient Gov. Administration	2	40%	0.8	60%	1.2
		Legal and Accounting System	2	80%	1.6	80%	1.6
		Infrastructure	3	60%	1.8	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	52.6	55.3	63.0	65.9

SRI LANKA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	5.8	5.8	5.1	4.9	5.1	5.0	4.3	1.5	2.7	--
By sector: Agriculture	3.1	6.9	2.6	5.0	-0.4	8.6	2.6	-5.8	2.1	--
Industrial Activity	4.9	2.5	2.6	1.8	7.0	3.5	6.1	6.3	4.2	--
Services	8.0	7.1	7.9	6.7	7.0	3.8	4.2	2.7	2.2	--
Per Cap. GNP-Current US $	260	300	330	340	360	390	410	410	420	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	10.51	10.57	11.48	11.19	12.11	12.43	12.67	13.09	13.54	14.02
Purchasing Index, US=100	26.37	22.32	21.55	21.47	19.53	18.30	18.89	18.33	17.81	17.33
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	2.04	1.78	1.86	1.98	2.12	2.28	2.29	2.27	2.43	--
Exports (fob) (1980 prices)	1.05	1.12	1.16	1.12	1.35	1.54	1.47	1.58	1.55	--
Current Account	-0.66	-0.44	-0.55	-0.47	.0009	-0.42	-0.42	-0.33	-0.39	-0.26
Capital Account	0.64	0.42	0.55	0.45	0.04	0.46	0.45	0.45	0.36	0.34
Changes in Reserves	0.23	0.06	-0.06	0.02	-0.25	0.05	0.05	-0.004	0.14	-0.02
External Debt	1.84	2.23	2.63	2.88	2.99	3.54	4.06	4.73	5.19	--
Interest Payments (on foreign debt)	0.03	0.05	0.07	0.09	0.11	0.12	0.12	0.13	0.13	0.11
Export Growth %	-3.0	6.8	3.6	-3.1	20.3	14.0	-4.5	6.9	-1.4	--
Terms of Trade % Change	-7.8	-5.3	-8.4	25.2	22.4	-17.7	-4.3	2.4	-6.6	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

SRI LANKA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	26.2	17.9	10.8	14.0	16.6	1.5	8.0	7.7	14.0	11.6
Fiscal Deficit (-)/Surplus as a % of GDP	-18.3	-12.4	-14.0	-10.6	-6.8	-9.7	-10.1	-8.7	-12.7	--
Investment Share of GDP %	33.8	27.8	29.9	28.3	26.0	23.4	23.3	22.9	23.1	--
Savings Share of GDP %	11.2	11.7	11.5	13.5	20.0	11.7	11.8	12.6	12.8	--
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	95.0	84.0	84.0	83.0	101.0	--	--	--	--
Government Share in Economy %[2]	24.9	17.6	18.3	18.2	16.5	20.2	19.0	20.2	18.5	--
Gross New Foreign Investment (US mn$)	43.0	49.3	63.6	37.8	32.6	26.2	29.7	59.5	45.7	19.6

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

THAILAND

Prepared for the Center for International Private Enterprise

THAILAND

General Assessment of Reform

- **Thailand's Sixth National Economic and Social Development Plan (1987-91) included a limited reform component which sought to encourage an increasing role for the private sector in development.** Under this plan, the government sector was to act primarily as coordinator, advisor, and supporter of the private sector. Private sector investment was projected to rise while the government's fiscal burden was to decrease. In particular, increased stress was placed on drawing the private sector into the rehabilitation of the nation's infrastructure, and into partnership in the development of commercial agriculture.

- **These reforms were undertaken at a time when the economy was stable, expanding, and private sector oriented.** Since the 1960s, Thailand has had a basically private enterprise economy with a strong agricultural export base. Government investment concentrated on infrastructure, while industrial activity developed in the private sector, albeit behind protective tariffs. Foreign investment was strongly encouraged with major concessions allowing ownership of land, repatriation of capital, waiving of duties on imported capital goods, and tax holidays.

- **With the implementation of the development plan the government also began to focus on biases that existed against smaller firms.** Particular attention was paid to investment incentives, the financial system, and the provision of industrial infrastructure. The government also addressed biases against heavy intermediate goods and capital goods industries that existed in the tariff structure. The strategy focused on industrial deepening and sophistication as a means of maintaining the country's export-led industrial growth.

- **This plan was developed in part to offset some of the distortions that had resulted from earlier import substitution strategies.** The emphasis on import substitution had resulted in a disproportionate investment in capital intensive (low employment) types of industries. As a result, industrialized Bangkok had developed a very high living standard while the vast bulk of the population still lived in the countryside in relative poverty. The government believed that the emphasis on

smaller firms would lead to more equitable distribution of income and assets, and that it would create more employment.

- **The reforms in this plan were instituted under a strong and independent prime minister.** General Prem Tinsulanon governed as prime minister for eight years with the support of the King, the military, and the senior civil servants. He relied heavily on the often Western-educated civil servants to provide the technical skills and long-term strategy for policy decisions, which he generally implemented with little regard for day-to-day party politics.

- **Many important reform issues were not addressed in the plan at all.** No aggressive opening of the domestic economy to foreign competition through the rationalization of import trade barriers was contemplated. There was little discussion of privatizing or reforming the existing state-owned companies. There was some discussion of improving the tax system, but no major changes have been made.

- **During this mild reform period of the late 1980s Thailand's economy achieved record high levels of performance.** From 1987 through 1989 annual growth in real GDP averaged in excess of 11 percent. Industrial activity grew at 12 percent per year, and the volume of exports grew more than 20 percent per year. While all of this growth cannot be attributed to the plan's stated objectives, analysts say that the reforms were a contributing factor.

- **The government's monetary policy and its control of exchange rates also played a role in this period's growth.** From 1987 until late 1989, higher economic growth was promoted through a "relaxed and flexible monetary policy" that permitted the broad money supply (M2) to grow on average about 22 percent per year compared with an average of 7.7 percent over the preceding three-year period. By any measure, this was a highly stimulative program. In addition, the country's exchange rate, which the government keeps closely tied to the U.S. dollar, fell relative to the yen, thereby increasing Thailand's attractiveness for offshore Japanese manufacturing.

- **Despite these export-oriented reforms, many of the policy instruments associated with the import substitution growth strategy remain in place.** A system of import licenses, arbitrary customs valuation procedures, outright imports bans, and heavy restrictions in the service sector continue to protect large segments of the domestic economy from the rigors of

foreign competition. To date, privatization has meant only the provision of services by private vendors under government contracts or multi-year concessions. In addition, the protection of intellectual property rights is so inadequate that the U.S. removed GSP waivers in 1989. Finally, financial markets remain highly regulated with a controlled system of interest rates and much intervention from the Bank of Thailand.

I. Background to Reform

A minor reform program aimed at maximizing private sector activity, while reducing the economic role of the state, was included in Thailand's Sixth National Economic and Social Development Plan. Part of the motivation for these announced goals was the fact that the government by itself was finding it difficult to play its traditional dominant role in infrastructure development given the country's rapid economic growth. Another factor was the need to correct distortions in the economy resulting from import substitution policies.

Thai economic policy has never been marked by sharp radical changes. Instead, policy has followed a pattern of incremental adjustments in the structure of the economy which dates from the 1960s. Through this method of gradualism, a major transformation of the Thai economy has taken place over the last 15 years. The reforms of the Sixth Development Plan must be evaluated in this context.

II. Evolution and Chronology of Thailand's Economic Reform

1979-80

Sharp oil price increases drastically raise Thailand's import bill:

A major investment program in alternative sources of energy is required.

Buildup of Vietnamese forces on Thailand's borders compels an increase in defense spending.

1980

General Kriangsak Chomanan steps down from the office of prime minister in the face of popular and parliamentary opposition to his economic policies.

General Prem Tinsulanon, an ex-army commander, becomes the new prime minister.

Thai government launches a structural adjustment course:

Fiscal retrenchment
Stronger tax collection
Competitive exchange rate management
Export promotion
Reduction of external borrowing.

1981

Discovery of natural gas in the Gulf of Thailand:

Fields begin to be tapped in September.

Prime Minister Prem survives a coup attempt led by the Young Turks" (a group of majors with experience in Vietnam).

1982

Introduction of the Fifth Development Plan (1982-86) with emphasis on:

Reduction of rural poverty
Maintenance of a balance between development and conservation
Export promotion
Intensified energy conservation and development of alternative sources
Reduction of budget deficit through efforts to increase government revenue.

1984

In November, the baht is devalued by 14.8 percent against the dollar and allowed to float against a basket of currencies.

1985

Collapse of "chit funds" (pyramidal money schemes offering interest rates as high as 6.5 percent a month).

During their existence, substantial funds were diverted out of the formal finance sector.

Textiles surpass rice as leading export commodity.

Second coup attempt with Prime Minister Prem in office:

Led by Mr. Manoon Roupkachom who was also part of 1981 attempt.

1986

Thai fund is established in New York and London:

A move to interest foreign investors in portfolio investment in Thailand.

Policy of export taxes (typically on rice) is abandoned.

1987

Bank of Thailand officially promotes a "more relaxed and flexible" monetary policy.

Solid position of Thai government has helped capitalize on favorable external environment which propelled Thailand's economic boom:

Conservative fiscal management
Competitive exchange rate policy
Export promotion strategies in industrial sector.

1988

Improved weather conditions boost agricultural sector; 8.6 percent growth.

Chatichai Choonhavan elected prime minister in August.

Government-controlled oil prices are cut by about 5 percent.

1989

The U.S. government removes U.S. Generalized System of Preference (GSP); competitive need waivers and denies Thai requests for other waivers because of inadequate protection of U.S. intellectual property.

Government imposes a logging ban after flooding and landslides plague southern Thailand, the result of illegal logging.

Ceiling is raised on annual public sector external borrowing by 20 percent to $1.2 billion.

Government approves new investments to improve deficient infrastructure.

Bank of Thailand liberalizes interest rate ceilings to encourage the mobilization of domestic and foreign savings.

Bank of Thailand relaxes foreign exchange controls to permit freer inflows and outflows of funds.

Continued large influx of foreign investment.

Improvement in tax administration and revenue collections (business tax and import duties).

Minimum wage rises to 76 baht per day on January 1 and to 78 baht per day (about $3) on April 1.

December 11: Council of Economic Ministers decides to liberalize the import of soybean meal.

Government discusses with various foreign commercial banks the conditions under which such institutions could open branches in Thailand.

The Thai government constitutes an intellectual property committee to draft patent law amendments.

1990

Seventh National Economic and Social Development Plan is completed and covers 1991/92-1995/96; objectives are similar to its predecessors.

Finance minister raises interest rates.

Government issues Bt30 billion worth of bonds and raises withholding tax on interest paid on foreign loans.

December 9: Prime Minister Choonhavan resigns but is immediately reappointed by the King.

Minister of Finance replaces the governor of the Bank of Thailand with his deputy:

> Chavalit, the new governor, changes the mood at the Bank and resolves to liberalize the Thai monetary system, with an emphasis on relaxing exchange controls.

In April, a World Bank report on Thailand's financial sector calls for wide-ranging changes:

Interest rate deregulation
Greater competition in the banking sector
Reforms of monetary authorities' intervention policies.

Finance Minister advocates a value-added tax (VAT) but it is delayed by cabinet approval.

III. Analysis of the Reforms

A. Timing

- **The reforms of the Sixth Development Plan were instituted in the final year of Thailand's longest serving modern prime minister.** The eight-year coalition government of General Prem came to an end in August 1988. General Prem had been appointed prime minister, rather than being elected. As such, he had remained aloof from party politics and worked closely with the country's technocrats. This plan was a product of that administrative environment.

- **General Prem was replaced by former general Chatichai Choonhavan, the first elected prime minister in 12 years.** From the beginning his government showed a pronounced shift from the aloof technocratic approach to one apparently guided by short-term political expediency and swift personal gain. This shift in administrative emphasis may have delayed and undermined many of the objectives set forth in the development plan. In February 1991, the Chatichai government was overthrown in a military coup which claimed to be responding to the government's growing corruption, and vowed to return the technocrats to positions of authority.

B. Sequencing

- **There are few specific events to mark the progress of this reform.** On account of the limited reform objectives of the Sixth Development Plan and the radical change in government administration, no major programs were instituted to specifically promote its goals. Some liberalization in financial markets took place and some changes in infrastructure policy occurred.

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Structural Reform Index (SRI)
Worksheet for Thailand

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1986		Reform Period 1987-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	60%	5.4	60%	5.4
		Low and Uniform Tariff Barriers	6	60%	3.6	60%	3.6
		No Local Content Regulations	4	60%	2.4	60%	2.4
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	70%	6.3	70%	6.3
		Minimal Exchange Controls	5	60%	3.0	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	60%	4.2
		Minimal Preferential Interest Rates	1	40%	0.4	50%	0.5
		Equal Access to Capital	3	60%	1.8	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	80%	5.6	80%	5.6
		Minimal Subsidies	4	60%	2.4	60%	2.4
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	80%	4.8
		Reduced Marginal Tax Rate	2	60%	1.2	60%	1.2
		Equitable / Uniform Tax Collection	2	50%	1.0	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	70%	3.5	70%	3.5
		Franchise Out State Services	2	60%	1.2	80%	1.6
		Simulated Privatization	3	60%	1.8	60%	1.8
7	Foreign Investment	Non-Discriminatory Treatment	6	80%	4.8	80%	4.8
		Proactive Promotion	1	80%	0.8	80%	0.8
2	Information	Free Flow of Market Information	2	70%	1.4	70%	1.4
16	Enabling Environment	Private Property Rights	9	60%	5.4	60%	5.4
		Efficient Gov. Administration	2	70%	1.4	50%	1.0
		Legal and Accounting System	2	60%	1.2	60%	1.2
		Infrastructure	3	40%	1.2	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED*		100	61.3	62.3	64.8	65.9

THAILAND

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	4.8	6.3	4.1	7.3	7.1	3.5	4.9	9.5	13.2	12.2
By sector: Agriculture	1.8	5.3	3.1	4.5	5.6	6.1	0.3	-2.0	8.6	--
Industrial Activity	3.6	5.7	3.1	8.2	8.5	-0.2	7.1	12.0	12.8	--
Services	6.9	7.1	5.1	7.8	6.9	4.8	4.6	10.1	10.7	--
Per Cap. GNP-Current US $	670	750	780	810	840	800	800	850	1000	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	14.85	14.72	14.71	14.51	15.13	14.39	15.02	15.11	15.18	15.25
Purchasing Index, US=100	41.75	40.67	38.61	39.67	33.87	29.32	34.09	35.62	34.70	33.65
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	9.45	9.78	8.69	10.85	11.33	10.14	10.30	12.77	19.37	--
Exports (fob) (1980 prices)	6.51	7.74	9.21	8.27	10.11	10.62	11.78	14.15	17.13	--
Current Account	-2.07	-2.57	-1.00	-2.87	-2.11	-1.54	0.25	-0.37	-1.66	-2.46
Capital Account	1.87	2.61	0.77	2.55	2.64	1.64	0.47	1.31	4.27	--
Changes in Reserves	0.21	0.03	0.11	0.18	-0.45	-0.24	-0.95	-1.28	-2.52	-4.87
External Debt	8.26	10.81	12.20	13.87	14.98	17.53	18.55	20.71	20.53	--
Interest Payments (on foreign debt)	0.27	0.39	0.48	0.52	0.85	0.91	1.03	1.07	1.18	1.16
Export Growth %	10.4	18.9	19.1	-10.3	22.3	5.0	10.9	20.1	21.1	--
Terms of Trade % Change	-8.7	-11.6	-13.0	5.7	-2.8	-6.9	15.1	-4.1	8.9	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

THAILAND

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	19.7	12.7	5.3	3.7	0.9	2.4	1.8	2.5	3.9	5.4
Fiscal Deficit (-)/Surplus as a % of GDP	-5.1	-3.5	-6.7	-4.1	-3.6	-5.6	-4.5	-2.4	1.1	--
Investment Share of GDP %	26.4	26.3	23.1	25.9	24.9	24.0	22.0	25.8	27.5	--
Savings Share of GDP %	20.1	20.0	21.4	18.7	20.6	21.2	24.1	26.1	25.8	--
Unemployment %	0.8	0.8	3.5	--	--	--	--	6.8	5.8	--
Real Wage Index[1] 1980=100	100.0	105.0	119.9	126.0	137.0	143.0	148.0	--	--	--
Government Share in Economy %[2]	14.6	15.0	16.3	16.0	16.3	17.6	16.9	15.7	15.9	15.3
Gross New Foreign Investment (US mn$)	190.0	294.0	191.0	350.0	401.0	163.0	263.0	352.0	1106.0	1699.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

TURKEY

TURKEY

General Assessment of Reform

- **Turkey's structural reform program since 1980 has been ambitious and extensive.** The program included liberalization in trade, financial markets, and foreign investment policies as well as rationalization and devaluation of exchange rates. Progress was also made in fiscal reform and privatization. The program was undertaken with full and massive support from the IMF, the World Bank and the OECD. The goal of this effort was to advance Turkey's long-established objective of becoming a modern European nation that is completely integrated into the EC. Existing agreements with the EC make this a credible objective for the country, despite the fact that near-term achievement of full membership is unlikely.

- **These reforms were pursued with an intensity sufficient to sustain them for ten years through a military coup and a return to civilian rule.** The individual most responsible for this sustained focus is Turgut Ozal. He was the architect of the reforms under military rule, served as prime minister in the first civilian government, and is now president.

- **The primary purpose of these reforms was to open up a closed and troubled, though rapidly industrializing, economy.** Turkey had entered the 1970s with rapid economic growth, low inflation, and a current account surplus. After the 1974 oil crisis, capital formation became less efficient, and expansionary fiscal and monetary policies led to a weakening trade balance and rising inflation. The growing import needs of industrialization exceeded export growth. In response, Turkey resorted to expanding levels of foreign borrowing. Demand management policies in the late 1970s, financed by multilateral organizations, were insufficient to stabilize the weakening economy because they were far too narrow in scope.

- **The reforms have brought about some fundamental changes in the Turkish economy.** The Turkish lira after an initial devaluation of 33 percent has slowly been freed of nearly all exchange controls. Progress has been made toward market-determined interest rates despite persistent high inflation. The country is now open to foreign investment, with most limits on foreign ownership and minimum export requirements removed. A stock exchange has been created and opened to foreign investors.

Price controls have largely been eliminated or tied to market conditions. Marginal tax rates have been reduced and a VAT tax modeled on EC standards has been introduced. Some steps toward privatization have also been taken.

- **The economy has on the whole responded well to these changes.** From 1984 through 1987 real growth averaged in excess of 6.5 percent per year, with the industrial sector performing even better— averaging almost 8 percent per year in growth. Deliberate restriction, to deal with inflation, slowed the economy in 1988, while 1989 and 1990 were adversely affected by severe drought. These last two years, however, achieved the first positive current account balance in over a decade. A major problem has been the failure to bring the fiscal deficit into line and to stem inflation which continues in the 35-65 percent range.

- **The single greatest shortcoming in Turkey's reform program has been the failure to adequately restructure the State Economic Enterprises (SEEs).** In 1988, these state-owned industrial organizations employed over 600,000 workers and accounted for about 45 percent of total public sector investment. Many of them run chronic deficits, which are a major cause of the government's fiscal problems and the country's high inflation. The reform program has tried to make the SEEs more efficient, competitive and market oriented, and plans continue for their eventual privatization. To date, however, progress has been slow compared to other aspects of the reform program.

- **Intellectual property rights are another area where reform is still required.** Patent protection for pharmaceutical and chemical products and their methods of production are considered wholly inadequate. Biological products, including plant varieties, are not patentable at all. There is widespread unauthorized copying and sale of books, motion pictures, sound recordings and computer software. Discussion within the government of improved protection in these areas continues. Some legislative changes have been made, but few changes in actual commercial practices have taken place.

I. Background to Reform

The IMF-supported stabilization program, which began in 1978, failed to reverse the deterioration of Turkey's economy. By 1980, Turkey was in dire need of a drastic change of course. In January 1980, a far-reaching stabilization and structural adjustment

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program was embarked upon with the help of the IMF, World Bank, OECD, and bilateral donors. The credits and financial assistance that was provided by these institutions was one of the largest operations of its kind.

The reforms that were initiated under the Turkish program were aimed at opening up the economy and promoting market forces. Besides moving the country toward external and domestic stability, these reforms also established Turkey's transformation from an inward- to an outward-oriented economy. Launched under the government of Prime Minister Sulyman Demirel, the reforms survived the military coup that removed him from power. This was due to the fact that the new leadership retained Turgut Ozal, then deputy prime minister, and gave him absolute authority for economic policymaking.

II. Evolution and Chronology of Turkey's Economic Reform

1978

Two consecutive standby arrangements are negotiated with IMF totaling SDR 310 million:

Turkish authorities adopt strict demand management policies.

Turkish lira devalued by 23 percent in March.

1979

Turkish lira devalued by 44 percent in June.

1980

Far-reaching stabilization and structural adjustment program embarked upon with support of IMF, World Bank, OECD, and bilateral donors.

Military coup removes Prime Minister Demirel from power; Deputy Prime Minister Turgut Ozal retained and given absolute authority for economic policymaking.

Turkish lira devalued by 33 percent.

Fixed exchange rates abandoned.

Quotas on imports replaced by tariff protection.

Tax rebates granted for exporters.

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Interest rate ceilings on demand deposits abolished.

Basic tax rate raised to 40 percent and income tax brackets are rearranged.

Exporters given the right to import materials and intermediate products duty-free.

Procedures involved in granting export incentives are simplified.

Streamlining of import licensing requirements.

Rediscount rate raised from 14 to 26 percent.

Interest rates paid to savers are freed.

Investment incentive regulations are simplified (foreign and domestic) and emphasis is placed on export-oriented activities, agriculture and tourism.

Prices charged by State Economic Enterprises (SEEs) are liberalized; consumer subsidies are eliminated or reduced.

1981

Capital Market Board is established, providing institutional framework for financial deepening.

Daily adjustment of the exchange rate.

Start of progressive reduction of income tax rates (eventually reduced to 25 percent in 1986).

Uniform corporate tax rate of 50 percent is set for all private firms.

Income tax reductions are granted on new exports; interest rates on export-oriented investments are reduced.

Indirect tax rebate rates are increased.

Imports are liberalized; quotas are eliminated, and transfers from the restricted list to free list take place.

Interest rates are freed on bonds.

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1982

Return to fixed interest rates.

Import liberalization continues with additional transfers of 200 items from a restricted to less restricted list.

1983

General elections in November officially end military regime; Turgut Ozal elected prime minister.

Introduction of tax rebates against proof of purchase of basic commodities and services.

Decrees announced to expand the authority of the Foreign Investment Department and to ensure the repatriation of earnings.

Bank liquidity requirement ratios are unified at 10 percent and are subject to daily monitoring.

1984

Elimination of export licensing requirements and export price controls.

Export subsidies are halted; trade promotion to take place through exchange rate policy.

Liberalization of exchange and payments system.

Turkish residents are allowed to open foreign-currency accounts with banks; payments, cash withdrawals and transfers abroad are permitted.

Practice of granting preferential tax rates to SEEs abandoned.

Commercial banks allowed to set non-preferential interest rates freely; preferential rates are raised significantly.

Import liberalization resumed; quantitative restrictions are reduced and custom duty rates and production taxes are cut.

Government takes first steps toward privatization by organizing and executing two public offerings of state-owned enterprises.

1985

Major banking reform legislation is completed.

Duties and production taxes on particular groups of commodities and services are replaced by a 10 percent VAT tax.

Prohibited list of imports phased out and reduced from 500 to 3 items.

Regulations governing other imports further eased.

Fiscal deficit is financed through weekly auctions of government paper to commercial banks and other financial institutions.

1986

Interbank money market is opened.

Istanbul Stock Exchange is reopened.

Introduction of a system of advance payments of corporate taxes to reduce collection lags.

Privatization is legally authorized.

Major relaxation of foreign investment regulations; limit on foreign ownership is abolished for most activities and minimum export requirements can be waived.

National Labor Office is reorganized to increase the supply of skilled labor.

1987

Banks are audited externally.

Two Free-Trade Zones are established and begin operating with the purpose of promoting export-oriented production and investment and as an incentive for foreign investors.

1988

Government establishes a Foreign-Debt Strategy Committee.

New fiscal policy package increases civil servants' salaries by 30-35 percent and adjusts income tax brackets for inflation.

Import regime further liberalized; "subject to permission" list is reduced from 111 to 33 items; customs tariffs on 234 items are lowered and all tariffs are now below 50 percent.

"4th February package" involves restrictive economic policy measures.

Introduction of a system of partial market-setting of the official exchange rate.

Turkish capital market admits foreign investors.

Indirect tax rates are increased, and VAT rates are adjusted to be consistent with those applied by EC member countries.

Interest rates are freed.

Export tax rebates are phased out and replaced by a system of export credits.

Public Participation and Mass Housing Fund agency begins work at privatizing the state sector; sales of portions of telecommunications, bottling, airline and cement companies take place.

1989

Yildirim Akbulut elected prime minister in November; Turgut Ozal advances to presidency.

Tariffs on imports of industrial supplies and finished products substantially reduced.

Foreign investment funds allowed to operate.

Permission granted for purchasing foreign securities and foreign currencies freely to Turkish residents.

Operation of an official gold market begins.

Income tax rates are rearranged to take account of high inflation.

Improvements in tax collection:

Ministry of Finance allowed to compound penalty interest payments for overdue taxes

Enforcement of compulsory closures of enterprises that systematically do not pay taxes
Computerization of local tax administration.

Serious drought, the worst in 50 years, reduces agricultural output by 10 percent.

1990

Further liberalization of currency regulations:

Banks allowed to set their own exchange rates.

Finance Minister Pakdemirli resigns on March 28.

Tighter fiscal policy measures include cutting the nonpersonnel expenditure targets of ministries by 12 percent (4 percent in defense).

A new tax law is considered that would gradually reduce rates but tighten up tax collection.

IMF increases pressure for stricter budgetary and monetary policies; the Fund is doubtful that Turkey can reduce its inflation rate to 30 percent by the end of the year.

Privatization efforts are still encountering difficulties; legal barriers are blocking the sale of state cement factories and the state airport handling company to European concerns.

Trade unions take a tough stance in their determination to increase wages; these attitudes are fueled by the high rate of inflation and the recovery in industrial output.

III. Analysis of the Reforms

A. Timing

- **The first moves toward reform were taken under the highly troubled government of Sulyman Demirel.** The economic chaos of the late 1970s and the failed IMF stabilization programs forced the move to more comprehensive reforms. The economic chaos, however, also contributed to the political weakness of the government. The military coup came about in part due to the government's inability to act.

- **Economic reform became part of the rationalization for military rule.** One of the key objectives which the military set for itself, before it would return the country to civilian rule, was to get the economy on its feet again. A combination of Turkish and multilateral influences convinced the military that the reforms planned by Ozal during the Demirel administration would do the job.

- **Ozal was elected prime minister at the end of the military rule in 1983.** He was elected largely on the reputation he had established directing the reforms under the military. This popular support allowed Ozal to continue to implement the reforms.

- **By 1987, when Ozal had to stand for reelection political considerations began to assert their importance over reform.** A major privatization program, which had been announced the previous year and had won legislative support, was downgraded in importance due to the elections. In addition, there now appears to be growing sentiment in the country that Ozal has stayed too long in power and brought too many family members into the government. As a result, political factors will probably play a growing role in Turkey's reform program.

B. Sequencing

- **The first steps toward reform taken by the military, largely in 1980 and 1981, were aimed at eliminating gross distortions.** There was 33 percent devaluation, an end to fixed exchange rates, and a move toward real interest rates. There was also a shift from import quotas to tariffs and some streamlining of import licensing. The tax code was first rationalized and then rates were reduced. Pricing by State Economic Enterprises was reformed to eliminate or reduce subsidies. The overall objective was to eliminate the more obvious impediments to export trade and economic efficiency.

- **After the return to civilian rule, the emphasis of reform shifted toward granting increased freedom within the economy.** Beginning in 1984 export licensing, price controls, and subsidies were all eliminated; and import restrictions were reduced or eliminated. Turkish residents were allowed to open foreign-currency accounts and to transfer cash abroad. Banks were allowed to set interest rates. An interbank money market and a stock market were opened. There was a general shift from reliance on regulation to increased use of market forces.

- **From 1986 through 1988 the reform moves were predominantly toward fuller integration with the world economy.** Most limits on foreign ownership were abolished and free trade zones were established. All tariffs were dropped below 50 percent and tariffs on industrial and finished product imports were substantially reduced. A system of partial market-setting of the official exchange rate was established. VAT rates were adjusted to be consistent with the EC. Foreign investment was opened to Turkish residents.

- **Late in the reform period, beginning in 1989, serious moves toward fiscal reform began.** Various moves were made to improve tax collection including tougher penalties for nonpayment, increased use of computers, and new tax laws to reduce rates but tighten collection. Tighter measures for controlling expenditures were also initiated. Some slow movement toward privatization also took place. Part of the impetus for these reforms was due to increased IMF pressure.

Worksheet for Turkey

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1975-1979		Reform Period 1980-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	30%	1.8	70%	4.2
		No Local Content Regulations	4	30%	1.2	80%	3.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	80%	7.2
		Minimal Exchange Controls	5	30%	1.5	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	80%	5.6
		Minimal Preferential Interest Rates	1	30%	0.3	80%	0.8
		Equal Access to Capital	3	30%	0.9	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	80%	5.6
		Minimal Subsidies	4	30%	1.2	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	50%	3.0
		Reduced Marginal Tax Rate	2	20%	0.4	80%	1.6
		Equitable / Uniform Tax Collection	2	20%	0.4	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	40%	2.0
		Franchise Out State Services	2	30%	0.6	40%	0.8
		Simulated Privatization	3	20%	0.6	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	80%	4.8
		Proactive Promotion	1	20%	0.2	90%	0.9
2	Information	Free Flow of Market Information	2	30%	0.6	80%	1.6
16	Enabling Environment	Private Property Rights	9	50%	4.5	70%	6.3
		Efficient Gov. Administration	2	30%	0.6	60%	1.2
		Legal and Accounting System	2	30%	0.6	60%	1.2
		Infrastructure	3	30%	0.9	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	29.1	31.2	70.0	71.3

TURKEY

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT															
Real % Change in GDP (1980):	8.0	7.7	7.0	-2.9	2.6	-1.1	4.1	4.5	3.4	6.0	5.1	8.1	7.4	3.4	--
By sector: Agriculture	10.9	7.6	-1.2	2.6	2.8	1.8	0.0	6.4	-0.2	3.5	2.4	8.0	2.2	6.6	--
Industrial Activity	8.8	9.8	8.9	6.2	-3.4	-4.4	5.6	3.9	6.3	8.5	5.6	8.8	9.0	3.4	--
Services	7.8	9.0	5.7	4.0	-0.3	0.8	4.3	4.1	4.4	5.7	4.1	6.0	6.9	4.5	--
Per Cap. GNP-Current US $	830	1000	1110	1200	1360	1390	1440	1290	1180	1100	1080	1110	1220	1280	1100
PURCHASING POWER PARITY COMPARISON															
Income Index, US=100	22.91	24.22	23.58	21.49	20.40	20.34	20.03	21.02	20.62	20.15	19.70	19.80	19.67	19.56	19.45
Purchasing Index, US=100	60.60	59.10	61.21	65.81	83.93	65.84	60.29	49.44	43.85	40.33	39.39	53.73	41.88	38.75	32.71
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)															
Imports (cif) (1980 prices)	8.20	8.98	9.55	7.22	7.57	7.57	8.54	9.03	9.93	11.82	12.94	13.88	15.96	15.61	--
Exports (fob) (1980 prices)	2.26	2.88	2.49	2.99	2.91	2.91	4.88	6.71	6.76	8.76	10.21	8.69	10.42	11.07	--
Current Account	-1.65	-2.03	-3.14	-1.27	-1.41	-3.41	-1.92	-0.94	-1.92	-1.41	-1.01	-1.47	-0.81	1.60	0.97
Capital Account	-0.02	0.30	1.01	-0.07	0.26	2.08	1.55	0.20	1.27	0.51	0.23	2.01	1.39	-0.44	1.75
Changes in Reserves	0.68	0.20	0.37	0.03	0.09	-0.09	0.00	-0.17	-0.15	0.72	0.11	-0.59	-0.66	-1.05	-2.67
External Debt	4.74	5.41	11.42	14.82	15.86	19.09	19.20	19.68	20.29	21.57	25.98	32.79	40.93	39.59	--
Interest Payments (on foreign debt)	0.11	0.14	0.17	0.16	0.25	0.51	0.96	1.17	1.24	1.18	1.32	1.50	1.90	2.43	2.67

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

TURKEY

Export Growth %	-7.9	27.6	-13.5	20.0	-18.2	19.1	67.6	37.6	0.7	29.6	16.6	-14.9	19.8	6.3	--
Terms of Trade % Change	-5.6	11.7	-3.7	-4.6	-3.1	-16.4	-7.1	-3.0	4.2	-1.3	-1.9	20.0	1.1	4.3	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

TURKEY

OTHER KEY INDICATORS	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	19.2	17.4	27.1	45.3	58.7	110.2	36.6	30.8	31.4	48.4	45.0	34.6	38.3	--	--
Fiscal Deficit (-)/Surplus as a % of GDP	-1.3	-1.9	-5.7	-3.9	-5.4	-3.5	-1.7	--	-4.2	-10.0	-7.4	-3.2	--	--	--
Investment Share of GDP %	23.2	25.1	25.2	18.7	18.6	21.9	22.0	20.6	19.6	19.5	21.0	24.4	25.4	24.0	--
Savings Share of GDP %	15.0	18.3	17.1	15.1	15.4	14.1	16.7	17.3	15.3	15.3	17.8	21.5	23.4	26.1	--
Unemployment %	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--
Real Wage Index[1] 1980=100	95.0	99.0	119.0	111.0	111.0	100.0	--	--	--	--	--	--	--	--	--
Government Share in Economy %[2]	15.8	16.7	19.1	19.7	20.5	19.1	17.1	0.0	17.5	19.8	20.9	17.8	18.5	--	--
Gross New Foreign Investment (US mn$)	121.4	11.3	26.9	31.2	70.4	18.2	95.5	55.0	46.0	113.0	99.0	125.0	115.0	354.0	663.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

CZECHOSLOVAKIA

Prepared for the Center for International Private Enterprise

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CZECHOSLOVAKIA

General Assessment of Reform

- **Czechoslovakia, under a new democratic government, has only recently begun the long, hard process of structural economic reform.** Starting in 1988, the former Communist government began reforming and liberalizing important aspects of the prevailing system. But a fundamental break with the centrally planned system was not contemplated. That decisive switch from socialism to a market-driven system is now under way, under the leadership of President Vaclav Havel. But the reform movement is still in its infancy. The government's commitment to a free, market-based economy amid higher inflation, unemployment and the resulting political backlash, remains to be tested.

- **In some important respects, the Czechoslovakian economy was structurally healthy when it entered an accelerated period of reform in the late 1980s.** Compared with other economies struggling with adjustment pressures, Czechoslovakia enjoyed low (although highly repressed) inflation, sound fiscal and monetary policies and little hard currency debt.

- **However, the reverse side of Czechoslovakia's economic discipline has been an excessive rigidity and sense of control.** Whereas, for example, Poland and Hungary have allowed for private property, Czechoslovakia has forbidden private ownership of shops and land. In addition, Czechoslovakia is more bound up in Central and Eastern European trade. The nation is also highly dependent on Soviet oil. Extrication from CMEA trading arrangement is, therefore, apt to prove difficult in a highly competitive world trade arena, in which Czechoslovakia has very limited experience.

- **The Civic Forum government endeavored to swiftly develop and implement an economic reform program.** It was able to do this with little parliamentary opposition or even discussion. Motivation for decisive reform action may have been supplied by a public opinion poll showing two-thirds of the population desiring to see reform start "as soon as possible." Accordingly, institutional reform efforts were begun, to formalize the country's new commitment to private property, a free market and more open relations with the non-CMEA world. Authorities also began the process of liberalizing prices, the exchange rate and interest rates.

- **Among Czechoslovakia's most aggressive reform moves have been the January 1, 1990 creation of a two-tier banking system.** However, questions exist as to whether the reform was too hasty, given the immaturity of Czechoslovakia's financial markets. One IMF-sponsored study has observed that the banks' capital/asset ratios are too low; that the system lacks competition between banks, and that monetary management is wrongly dependent on direct credit controls instead of indirect monetary controls.

- **Czechoslovakia's aggressiveness in economic liberalization under the Civic Forum government has been tempered by its desire to avoid destabilizing actions.** For example, freeing of prices and allowing the "internal convertibility" of foreign exchange (allowing enterprises to buy and sell hard currency among themselves) was made dependent upon Czechoslovakia's receiving assistance from the IMF and external donors. Officials were concerned that without this aid Czechoslovakia would not have sufficient reserves to cushion itself against any market turbulence that might appear.

- **Regional frictions that have appeared in the democratic period could slow the future pace of reform.** Some powerful voices representing the more underdeveloped Slovakian region are now urging a slower reform pace and the retention of an interventionist state in economic affairs.

- **Czechoslovakia, along with Hungary, has been the most successful Central and Eastern European reform country in terms of attracting foreign investment.**

I. Background to Reform

After severe repression for the reform efforts in 1968, the Czechoslovakian economy endured over 20 years of intense central planning and control. During this time attempted changes to the economic system were limited to major price restructurings in 1977 and in 1981-82 (mainly a reaction to world price increases resulting from the first and second oil price rises), and modest reform initiatives in the late 1970s and 1980s that sought to improve the operation of the planning system through greater emphasis on rewarding skill and innovation and on penalizing poor performance. These initiatives evolved in the form of an experiment in economic reform that began in 1978 with a decree calling for a "Comprehensive Experiment for Controlling Efficiency and Quality of Production."

Additional guidelines were laid out in 1981, and then in 1987 and 1988. This experimental approach to economic reform involved testing some reform measures on a small number of enterprises. The piecemeal strategy did not bring satisfying results due to the absence of rational prices and the inability of experimental enterprises to perform effectively vis-à-vis non-experimental enterprises. By late in the decade, Gorbachev's *perestroika* inspired an enthusiasm for reform in the population but at the same time caused a split in the country's leadership; a governmental commitment to reform eventually won out. The most substantial framework for economic reform was adopted in 1988 and legislation was enacted in 1989. The plan for restructuring went into effect on January 1, 1990.

II. Evolution and Chronology of Czechoslovakia's Reform

1978

Government approves a decree calling for a "Comprehensive Experiment for Controlling Efficiency and Quality of Production":

Decree is applied to 12 producer associations, 9 trade organizations and 21 research and development institutes.

1981

Adoption of the "Set of Measures to Improve the System of Planned Management of the National Economy After 1980."

"Measures to Improve the System of Planned Management of Agriculture."

1983

Reform experiment begun in 1978 is extended into the foreign trade sector.

1985

Government approves the concept of joint ventures with Western firms.

Perestroika is actively pursued in the Soviet Union as Mikhail Gorbachev assumes the party leadership and presidency of the country.

1987

"Principles of Restructuring of the Economic Mechanism" is announced:

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Selected enterprises start to experiment with reform measures; i.e., full self-financing, greater independence in foreign trade.

Bill of the State Enterprise is issued for public discussion.

1988

New Economic Mechanism is put into motion and "Complex Reconstruction" guidelines are published.

Scope of the New Economic Mechanism experiment begun in 1987 is expanded to include further industrial enterprises, domestic trade as a whole, services, and agricultural and food production.

Dissolution of old "economic units" (associations) begins, and independent State Enterprises are created.

Law of the State Enterprise:

Establishes the enterprise as an independent legal person who can compete in a (regulated) market environment
Employees are given a voice in the selection of managers
Laws on the State Economic Tribunal and the Economic Statute are amended accordingly
Enterprises undertake detailed planning decisions previously reserved for the State and laid out in the annual plans; incentive pay and rewards for meeting final demand rather than plan targets are increasingly emphasized.

New Joint Venture Law is passed:

Lifted previous constraints and provided new legal guarantees
Joint ventures could operate according to contracts without any State interference
Foreign majority holdings are allowed
Repatriation of profits in convertible currencies is guaranteed.

1989

System of multiple exchange rates is simplified:

Commercial exchange rate is devalued by 173 percent.

Wholesale prices are restructured as the first stage in a reform of the price system:

Prices are determined on the basis of average costs plus a uniform rate of return of 4.5 percent on capital and total stocks.

Banking Law:

Introduction of a two-tier banking system consisting of a central bank and independent commercial and savings banks.

Law on Exchange Control:

Regular foreign exchange auctions are started
Foreign exchange retention scheme is introduced in order to encourage exports to the convertible currency area
System of foreign trade taxes is modified.

In November, Civic Forum is formed. It is a multiparty political group demanding sweeping change. Threats of strikes force government to concede its position of dominance. Czechoslovakia begins swift move toward political democracy.

1990

A single bank (minimum lending) rate is established and set at 4 percent:

Rate is later raised to 5 percent in April and 7 percent in October.

Mixed system of centralized and decentralized prices is introduced:

Prices now fall into three categories: centrally determined prices, centrally regulated prices, and contract prices
About 25 percent of prices are liberalized.

Czechoslovak Koruna is devalued by 19 percent.

Czechoslovakia submits application to rejoin the IMF in January and enters in October.

Joint Venture Law is amended:

Law is simplified and liberalized and a series of bilateral international agreements are made providing guarantees to foreign investors.

Law on Small Businesses is passed to support the emerging private sector:

Replaces licensing with simple registration.

Law of the State Enterprise is amended and a new Company Law is passed:

Prepares conditions for greater independence of enterprises and their eventual privatization
A large number of enterprises are created by further dissolution of former industrial associations.

Fiscal policy is tightened:

Provisional budget for the first quarter of 1990 and subsequent regular budget are aimed at a surplus
Credit is cut.

Export regulations are liberalized.

Commercial property market is liberalized.

Food subsidies are mostly removed.

In June, Civic Forum coalition triumphs in first contested election since 1946:

Vaclav Havel is president
Dominant economic leader is Finance Minister; Vaclav Klaus.

Investment promotion agreement is established with the United Kingdom, followed by similar agreements with other countries.

Land prices are liberalized.

Membership in the World Bank is renewed.

A bill allowing the return of confiscated property is passed.

Czechoslovak Koruna is devalued by 54 percent.

Lack of momentum characterizes the formation of laws designed to help foreign investors.

Authorities draft a privatization law:

Applies only to services (restaurants, shops and other small businesses); fate of big State companies is still under discussion.

Minister for Ownership Transformation submits a privatization plan, the core of which is a voucher program giving Czechoslovakian citizens the right to obtain shares in companies.

1991

January 1 Measures:

Price liberalization of retail and wholesale prices
Sale of small businesses (scheduled to begin at the end of January)
Internal convertibility of Czechoslovak Koruna; Czechoslovak firms licensed to conduct trade can now buy as much foreign currency as they want at the newly unified exchange rate.

Planned for 1991:

Establishment of a stock exchange
Minor and major privatization.

III. Analysis of the Reforms

A. Timing

- **Exogenous economic shocks did not precipitate Czechoslovakia's structural economic reform program.** In fact, the nation successfully weathered the early 1980s decline in its terms of trade, without experiencing acute external imbalances or high inflation. Czechoslovakia did not — and does not — suffer a huge external debt burden. Instead of pressing economic hardship, what seemed to set the reform movement in motion was the solidification of government concern, by the late 1980s, over the festering problems of slow growth, insufficient investment levels, poor labor productivity and severe environmental problems, among others.

- **Growing popular discontent spurred official action.** Decades of repressive government fed pressure for both political and economic reform. This desire for change was not acute. However, reform pressure became more urgent with the unfolding of the radical reform program of Mikhail Gorbachev in the Soviet Union. The Communist leadership, which derived its authority

from Moscow, could hardly ignore Gorbachev's revolution, although they did seek to limit the scope of reform in Czechoslovakia.

- **The Civic Forum's electoral victory in 1989 signaled a change from mild to aggressive economic reform.** The old leadership had been convinced of the need for limited change. The new leadership stated unequivocally its objective of creating a full-market economy. As it pursues structural economic reform, the Civic Forum government, under the leadership of the popular President Vaclav Havel, enjoys the advantages of political legitimacy and widespread popular backing. The latter, however, could be eroded if a short-term decline in living standards results. Another potential source of resistance to change is the underdeveloped Slovakian region of Czechoslovakia, which continues to favor relatively high-level government intervention in the economy.

B. Sequencing

- **However inconsistent and inadequate, steps taken by the old regime in the 1988-89 period helped lay the groundwork for broader-based reform.** For example, large economic units were dissolved and independent state enterprises were erected in their place. These independent entities were assigned limited property rights. Also, enterprise self-financing was promoted and select state companies were granted freedom to conduct their own affairs in external trade. The foundation of a new banking system was also constructed in the immediate pre-democracy period.

- **The end of Communist rule marked a second structural reform stage.** This period involved clarification and identification of systemic reform measures, and the establishment of a basic legal framework for private property rights and joint ventures. These institutional reform activities were accompanied by an initial wave of specific adjustment measures, including subsidy reductions, a phased but significant devaluation of the exchange rate, and tight controls on state spending. Further underlining Czechoslovakia's opening was its renewal of IMF membership in late 1990.

- **Czechoslovakia is currently in a third reform stage, which calls for more vigorous price and foreign exchange liberalization measures.** In preparation for this, authorities imposed tight fiscal controls leading to a budget surplus. They also

tightened credit and reduced liquidity. Privatization of smaller state companies is now planned. Receipts will be channeled into commercial credit to stimulate what has been the weakest element of the reform— the supply side. Inflation and unemployment rates will be watched carefully as the key indicators of the relative success of this third reform stage.

Structural Reform Matrix (SRM)
Worksheet for Czechoslovakia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1987		Reform Period 1988-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	10%	0.9	40%	3.6
		Low and Uniform Tariff Barriers	6	10%	0.6	50%	3.0
		No Local Content Regulations	4	50%	2.0	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	50%	4.5
		Minimal Exchange Controls	5	10%	0.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	10%	0.7	50%	3.5
		Minimal Preferential Interest Rates	1	20%	0.2	60%	0.6
		Equal Access to Capital	3	10%	0.3	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	10%	0.7	30%	2.1
		Minimal Subsidies	4	20%	0.8	40%	1.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	70%	4.2	90%	5.4
		Reduced Marginal Tax Rate	2	50%	1.0	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	00%	0.0	20%	1.0
		Franchise Out State Services	2	10%	0.2	10%	0.2
		Simulated Privatization	3	30%	0.9	50%	1.5
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	70%	4.2
		Proactive Promotion	1	20%	0.2	50%	0.5
2	Information	Free Flow of Market Information	2	10%	0.2	50%	1.0
16	Enabling Environment	Private Property Rights	9	20%	1.8	50%	4.5
		Efficient Gov. Administration	2	30%	0.6	60%	1.2
		Legal and Accounting System	2	40%	0.8	50%	1.0
		Infrastructure	3	50%	1.5	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	24.8	22.1	50.4	50.3

CZECHOSLOVAKIA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
NET MATERIAL PRODUCT										
NMP Annual Growth Rate %	2.9	-0.2	0.3	2.1	3.7	2.9	2.5	2.2	2.3	1.8
By sector: Agriculture	4.8	-2.5	4.4	4.3	4.5	-1.6	0.6	1.0	2.8	1.0
Industry[1]	3.5	2.2	1.0	2.9	4.0	3.5	3.2	2.5	2.1	1.1
Freight Transport	4.2	2.3	0.9	0.8	0.1	-1.7	2.6	-1.0	1.3	--
Construction	1.4	-2.3	-4.8	2.3	2.0	0.8	2.6	2.1	0.1	--
EXTERNAL TRADE (bn Koruna, Unless Otherwise Indicated)										
Trade Balance: Non-Socialist Countries	0.0	1.9	2.9	4.9	5.3	4.3	1.8	-0.8	-0.6	4.29[2]
Non-Socialist Countries: Developed West	--	--	--	-0.2	1.3	0.4	-1.6	-2.9	-2.3	1.1
Socialist Countries	-1.4	0.4	-1.8	-4.1	-4.8	-4.8	-5.4	-0.6	4.3	-1.5
Export Growth % (Non-Socialist Countries)	25.5	4.0	-1.4	5.7	3.9	0.6	-1.1	-4.4	6.9	13.6
Import Growth % (Non-Socialist Countries)	10.6	-3.6	-6.2	-2.4	3.0	5.1	9.7	5.3	6.1	6.1
Terms of Trade (1970 = 100)	82.1	--	76.0	73.0	66.6	67.3	66.6	68.5	70.1	--
OTHER KEY INDICATORS										
Inflation %	2.9	0.8	5.1	0.9	1.0	2.3	0.5	0.1	0.3	1.6[3]
Money in Circulation - Annual Growth Rate %	5.8	4.1	6.6	7.0	5.5	3.4	4.1	4.4	6.5	5.9[3]
Net Investment Share in NMP %	26.0	20.1	20.4	19.5	19.8	19.4	20.3	18.8	17.9	--
Gross Investment - Annual Growth Rate %	1.4	-4.6	-2.3	0.6	-4.2	5.4	1.4	4.4	4.1	2.1

[1] Excluding construction.
[2] At July 1990 exchange rate.
[3] November 1989/November 1988

Sources: Cz. Statistical Yearbooks (Prague)
Economic Intelligence Unit: Czechoslovakia 1989-90, Country Profile (London).
Statisticke Prehledy (Federal Statistical Bureau, Prague).

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

HUNGARY

HUNGARY

General Assessment of Reform

- **Structural, market-oriented economic reform in Hungary has been evolving for more than 20 years, despite uneven policy performance over that period.** Hungary has achieved a high level of economic decentralization, relative to other Central and Eastern European countries, and has succeeded in creating a viable framework for private enterprise. The process is still far from complete, as the economic system remains dominated by the state and cooperative sectors. A new, more intense period of reform has been under way since 1988-89, however. Over the next several years, the state sector is scheduled to undergo massive downsizing and reform, as the new democratic leadership strives to achieve sustained economic growth and modernization. The Programme of National Renewal, the economic reform program of the present government, calls for the creation of a social market economy, in which private ownership is the dominating force.

- **In the Central and Eastern European context, Hungary stands out for having granted private property rights early on.** A structure for private ownership was already present when the latest economic reform drive was launched. Apart from industry, which remained dominated by the state, by 1988 a small but fast-growing private sector operated in all sectors of the economy. Almost 40 percent of agricultural produce came from private farmers. Two-thirds of newly commissioned dwellings were built by small private firms or by the owners themselves. In retail trade, the share of private shopkeepers in total turnover was about 12 percent. Moreover, a large segment of the population possessed a relatively important stock of accumulated wealth. In 1985, more than 70 percent of active households lived in their own homes, nearly 40 percent of them had their own car, and 6 percent had a secondary home as well.

- **Successful privatization is critical to the government's reform plans. However, only about one-tenth of all targeted state assets have been privatized.** Powerful forces have resisted the process. The leading party in the government coalition, the Hungarian Democratic Forum (HDF), has been strongly opposed to the "spontaneous" variety of privatization (which was the practice during the last Communist government) whereby the sale of an enterprise was initiated or undertaken by the management of the enterprise itself. The HDF's opposition to spontaneous

privatization rests in its fear that enterprise managers and top government officials would realize illicit monetary benefits from hasty and poorly supervised privatizations.

However, the present government's cautious and gradual approach to privatization will probably prove unworkable if the government is to make significant progress in reducing the state's share in these enterprises.

- **The labor market had been progressively liberalized in the post-1968 period, but in many areas the real breakthrough occurred in 1989-1990.** Domestic private firms, previously limited to a maximum of 30 (later 500) employees, may now increase payrolls without limit. These ventures, as well as those with foreign participation, are allowed to pay market clearing wages. It is a widely shared view, however, that Hungary's extremely progressive tax system effectively undermines this freedom.

- **Hungary has made significant gains in liberalizing terms for foreign investment.** Rights, guarantees and privileges of foreign investors are protected by a special act providing a legal framework for the activities of partly or wholly owned foreign economic units, including the repatriation of profits. As of October 1, 1990, Hungary has agreements on mutual protection of foreign investments with 18 Western countries. Treaties on avoidance of double taxation have also been concluded by not less than 29 nations.

- **Despite significant reform progress, the Hungarian economy remains deeply troubled.** Real wages have been falling— practically without interruption— since 1981, and the nation's debt burden remains unwieldy. Without a major debt restructuring, some $1.4 billion in interest and $1.9-2.3 billion in principal, are due annually in the next few years. In 1990, interest payments on the hard currency debt alone amount to 5 percent of GDP. The total impact of the upcoming changes in 1991 (the change from rouble to dollar trade within the CMEA, the Gulf crisis and a poor harvest in 1990) is estimated to have cost a further 4-5 percent in terms of lost GDP.

- **Hungary's future prospects for stability and recovery depend on longer-term foreign debt-restructuring.** Hungary's $21 billion foreign debt is the largest in per capita terms in all of Central and Eastern Europe. It is a huge management burden. Since 1989, the G-24 governments have committed some $8 billion in new capital to Hungary, but 95 percent of this was debt-creating (new loans) or conditional (investment and credit

guarantees). The IMF and the World Bank have provided sizeable loans as well. Still, it is increasingly evident that, along with a massive infusion of non-debt-creating foreign direct investments, Hungary needs relief through debt rescheduling and/or debt reduction.

I. Background to Reform

For a socialist country, Hungary has traditionally maintained an exceptionally liberal and open economy. Its New Economic Mechanism, announced in 1968, marked the first stage of a transfer of economic power from the central government to individual enterprises. The New Economic Mechanism involved radical reforms and supported the rise of consumer services, mostly in the private sector. Reform met with much opposition in the mid-1970s, however, and strong government intervention was renewed. The protracted reform process began again in 1980, with efforts to encourage small enterprise formation and make the economy more flexible.

Despite Hungary's reform efforts, the nation experienced serious economic hardship in the 1980s. Growing debt service payments and an overvalued currency had given rise to expanding hard currency current account deficits. Inflation and unemployment were creeping upwards, and the government was still subsidizing and maintaining a number of loss-making state enterprises. An austerity program was launched in 1986-87 and succeeded in stabilizing the economy in the short run. Radical reforms aimed at restructuring the economy were initiated in 1988, and by 1989, policies for liberalizing trade and promoting privatization had begun to take shape.

Hungary has made a successful transition from Communist rule to multiparty democracy. The process has been smooth and peaceful. The country has had free elections (both nationwide and at local levels), in which only moderate forces were able to achieve success. The nation is governed by a coalition of three conservative parties: the Hungarian Democratic Forum (HDF); the Independent Smallholders', Farmworkers' and Citizens' Party; and the Christian Democratic People's Party. The prime minister is Mr. József Antall from the HDF.

II. Evolution and Chronology of Hungary's Economic Reforms

1968

New Economic Mechanism abolishes rigid central planning and moves the economy toward reliance on market forces; involves radical reforms:

- Central planning is confined to the regulation of investment and foreign trade
- Unified foreign exchange multipliers
- Introduction of customs tariffs
- Enterprises have greater economic independence.

1972

Strengthening of antireform political forces.

First joint-venture law.

Hungary joins the Eurocheque system:

- Tourists now allowed to engage in transactions using dollar-denominated Eurocheques.

1973

Accession to GATT (reduction of tariffs by one-sixth).

1975

Foreign Trade Act passed; it represents a unified piece of legislation that replaces thousands of government decrees regulating foreign trade.

1976

Introduction of realistic exchange rates for convertible currencies.

1977

Amendment of joint-venture legislation:

- A majority stake for foreigners is allowed in the service sector.

1978

Hungarian Socialist Workers' Party (HSWP) adopts policy guidelines to stimulate external adjustment:

Piecemeal economic reforms are aimed at making the country's production and consumption structure more compatible with world-market conditions.

U.S. accords "most favored nation" treatment to Hungary.

1980

Wholesale price reform:

Competitive wholesale prices introduced in industry
Consumer price increases become a regular feature of daily life.

1981

First bond issues by local authorities.

Unified exchange rate for the Hungarian forint is introduced.

1982

Severe balance-of-payment crisis, prompted by Latin American debt crisis and subsequent withdrawal of Western depositors from Hungarian National Bank.

Hungary joins the IMF and the World Bank.

First IMF standby agreement (SDR475 million); SDR72 million in compensatory financing.

Law on free-trade zones.

Further relaxation of joint-venture legislation.

Law decree on bond issues.

1983

Rapid growth of small-scale ventures in industry and the service sector.

Obligatory tenders for major investment projects.

1984

Drastic reduction of quantitative import restrictions.

First joint-venture in the free-trade zone.

Start of negotiations with EEC on a trade agreement.

Second IMF standby agreement (SDR425 million).

The HSWP and the government approve guidelines for a medium-term reform package:

Integrated bank rate replaces earlier ad hoc system of interest rate setting
New taxation system
Simplified accounting practices, etc.

The first enterprise bankruptcy.

Creation of new commercial banks.

Individual import licensing is largely abolished.

1985

Modification of the Enterprise Act:

Introduction of new corporate forms, including self-management.

The Central Bank's credit monopoly for credit expansion is eliminated.

Within the Central Bank, commercial banking functions are separated from central banking functions.

Daily quotation of exchange rates.

First public discussions about the need for (Western) foreign direct investments.

1986

Liquidation of state monopoly in the insurance business.

Decrees on business insolvency and liquidation; replaces obsolete nineteenth century legislation.

1987

Bank reform:

Two-tier bank system created, separating commercial banking from central banking system
Liberalization of the interest rate system
SOEs are allowed to finance freely their working capital
Four-month wage freeze.

Final abolition of compulsory price formation rules, adopted in 1980.

A program of radical reform is produced and published by a group of experts (Turnaround and Reform).

SOEs may freely choose the commercial bank which keeps their account.

First investment protection agreement with a Western country (Sweden).

Act on land ownership.

1988

Tax reform; introduction of:

VAT (25 percent)
Personal income taxation, 20 percent.

Most prices in industry and the service sector are freely determined by market forces.

Any enterprise can register for foreign trade transactions.

Free travel to the West for Hungarian citizens.

Opening of the inter-bank security market.

Private firms can employ 15-30 persons.

First association of employers.

Short-term treasury bills appear to finance budget deficit.

First independent trade unions.

Near-collapse of the bond market.

First major anti-government demonstration on environmental matters.

Third IMF standby (SDR266 million).

After 32 years of rule, Mr. J. Kádár is removed from the office of party leader and given strictly honorary position of president of the party.

Commercial banks may obtain license for keeping foreign exchange accounts of both individuals and firms.

First major industrial action (coal miners' strike).

Trade and cooperation agreement signed with the EEC.

Creation of a tripartite commission for wage negotiations.

1989

New company law is passed, defining forms of business associations:

Act on Economic Associations
Act on Investments of Foreigners
Corporate Profit Tax.

Liberalization of Western imports; ends case-by-case quota system.

Introduction of unemployment compensation.

Commercial banks replace the National Bank for the quoting of future rates for foreign exchanges.

Strike law.

Commercial banks may accept foreign exchange deposits from passing customers (but not banks).

Trilateral political negotiations on a new constitution.

Transformation of Corporations Act— Allows SOEs and cooperatives to transform themselves into limited liability or shareholding companies.

Commercial banks may grant loans from their foreign exchange deposits to Hungarian business organizations.

Major political groups agree on six draft bills to set in motion a peaceful transition to democracy following four decades of communist rule; Parliament approves the legislation.

Start of the Economic Deregulation Council.

Overall business tax rate is reduced from 54 to 45 percent and personal income tax brackets are lowered.

Hungarian currency, the forint, is devalued three times, for a total of 23 percent.

Import reference prices are reduced from an average of 50 percent to 30 percent.

1990

Hungarian Democratic Forum and its allies emerge victorious in elections. József Antall is chosen to be prime minister:

Antall takes a month to form a government.

Start of the State Audit Office to supervise the financial activities of the government.

Six major commercial banks allowed to finance convertible currency transactions in foreign trade.

Four banks, all with Western participation, are authorized to participate in credit and loan operations on Western markets.

Liberalization of trade with the West imports, following collapse of East Bloc trade (CMEA).

Introduction of uniform Commercial Customs Tariffs.

Employment Fund is created to ease labor market tensions.

Security law:

Act on the Public Issue and Public Trading of Securities.

Fourth IMF standby (SDR159 million).

Act on the State Property Agency (SPA) and on the Management and Utilization of State Assets:

First phase of a five-year program to privatize a significant portion of the Hungarian economy. First phase, covering several months, contemplates privatization of 20 state companies. Some 90 percent of industry is state owned; government hopes to reduce that figure to 50 percent within five years.
SPA publishes a simple guide on how to buy a state company within 100 days.

Opening of the Stock Exchange.

Constitutional Court forbids reprivatization of land.

Three-day nationwide lorry- and taxi-driver strike paralyzes the country.

Government sets plans to liberalize petrol prices.

Reports circulate that government plans to make forint convertible.

Local elections favor opposition.

III. Analysis of the Reforms

A. Timing

- **Hungary's economic reform efforts were initially undertaken by the ruling elite to address both the perceived structural weaknesses in the economy and, to deal with the negative effects of those weaknesses.** Early on, the leaders of the Communist party, the most influential enterprise managers and government officials, were driven by their own growing dissatisfaction with the overall performance of the economy. There were, in fact, two different levels of dissatisfaction. First, there existed general dissatisfaction with the irrationalities of the existing system. Second, national leaders were dissatisfied with the country's poor growth performance and its vulnerable external position.

- **The extraordinary, and totally unexpected, developments in Central and Eastern Europe and the Soviet Union in late 1989 constituted a major turning point in the Hungarian reform process.** In reaction, the ruling elite in Hungary deliberately broadened the range of issues open to discussion. The idea of multiparty elections at home, a critical approach toward the Soviet Union in international relations, and the strengthening of political ties with the West, all were entirely new elements of policy thinking. At the same time, the emerging, new political parties proved to be much more popular than they themselves thought. By the time of Hungary's national elections (March 1990), the majority of voters wanted a total breach with the past 40 years. This greatly expanded the parameters for economic, as well as political, change in Hungary.

- **Hungary's poor economic performance in 1989 also helped explain the intensification of reform policies since that time.** With a reduced international credit rating, the country had fewer borrowing options. It realized that substantive reforms were needed to retain the confidence of its Western creditors, as well as to keep the economy on track for its own sake.

B. Sequencing

- **The structural economic reform drive now in progress is benefiting from the fact that Hungary had already accomplished important institutional reforms prior to 1988.** There already existed, for example, private property rights and a relatively liberal framework for foreign investment. Also, wages and prices, while centrally controlled, did allow for the interplay, albeit restrained, of the forces of supply and demand.

- **Hungary's price liberalization efforts have clashed with a lax monetary policy.** The government is in the process of dismantling the existing controls on wages and prices. This policy has already brought some fruits, in terms of allowing market forces to more efficiently allocate resources. In the absence of a sufficiently tight monetary policy, however, inflation has accelerated.

- **Privatization, in the broad sense, lies at the heart of Hungary's reform agenda.** The current state company subsidy structure is untenable from both the standpoint of Hungary's fiscal stability and the structure of prices in the country. Critical to the pricing issue is the continued opening of trade to the West, which has been accelerated both by trade liberalization policies and the collapse of the CMFA trade bloc.

- **The situation of Hungary's agricultural cooperatives underlines the complexity of reprivatization for a struggling new democracy undergoing profound economic restructuring.** One faction of the ruling party sought restoration of land ownership rights as of 1947— prior to collectivization. The Constitutional Court ruled that planned land restitution measures were unconstitutional, as they amounted to unlawful discrimination among citizens. The land, the court ruled, could not be confiscated for the benefit of former owners without adequate compensation.

Structural Reform Matrix (SRM)
Worksheet for Hungary

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		Minimal Exchange Controls	5	30%	1.5	40%	2.0
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		Minimal Preferential Interest Rates	1	40%	0.4	50%	0.5
		Equal Access to Capital	3	30%	0.9	30%	0.9
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10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	40%	2.4
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		Equitable / Uniform Tax Collection	2	50%	1.0	50%	1.0
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		Franchise Out State Services	2	30%	0.6	40%	0.8
		Simulated Privatization	3	30%	0.9	30%	0.9
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		Proactive Promotion	1	60%	0.6	70%	0.7
2	Information	Free Flow of Market Information	2	80%	1.6	80%	1.6
16	Enabling Environment	Private Property Rights	9	40%	3.6	50%	4.5
		Efficient Gov. Administration	2	60%	1.2	70%	1.4
		Legal and Accounting System	2	60%	1.2	60%	1.2
		Infrastructure	3	40%	1.2	40%	1.2
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	44.3	42.7	52.6	52.6

HUNGARY

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	0.1	2.9	2.8	0.7	2.7	-0.3	1.5	4.1	-0.1	-0.2
By sector: Agriculture	3.8	3.3	11.7	0.5	4.6	-4.1	1.7	-1.3	7.9	-1.8
Industrial Activity	-1.4	5.0	4.7	1.8	2.5	-2.1	-0.5	3.2	-1.5	-3.4
Services	-0.5	3.7	0.9	1.8	3.0	2.7	4.0	4.8	-2.6	2.9
Per Cap. GDP-Current US $[1]	2063	2122	2161	1963	1900	1935	2255	2458	2637	2728
EXTERNAL TRADE AND BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif)	9.2	9.2	8.9	8.6	8.1	8.2	9.6	9.9	9.4	8.9
Trade in non-convertible currencies	4.2	4.2	4.3	4.1	3.8	3.9	4.7	4.5	4.0	3.4
Trade in convertible currencies	5.0	5.0	4.5	4.5	4.3	4.3	4.9	5.4	5.3	5.5
Exports (fob)	8.6	8.7	8.9	8.8	8.6	8.5	9.2	9.6	10.0	9.7
Trade in non-convertible currencies	3.7	3.8	3.9	3.8	3.7	4.0	4.7	4.6	4.1	3.7
Trade in convertible currencies	4.9	4.9	5.0	5.0	4.9	4.4	4.5	5.0	5.9	6.0
Current Account	--	--	--	--	0.06	-0.8	-1.5	-0.9	-0.8	-1.4
Capital Account	--	--	0.3	-0.1	-0.1	0.8	1.5	0.9	0.8	1.4
Changes in Reserves	--	--	0.8	-0.8	-0.8	-0.4	-0.1	0.9	0.0	0.1
External Debt	--	--	10.2	10.7	11.0	14.0	16.9	19.6	19.6	20.6
Interest Payments (on foreign debt)	--	--	1.2	0.9	0.9	1.0	1.2	1.2	1.3	1.6
Export Growth %	1.0	2.6	7.3	9.4	5.8	-0.3	-2.2	4.0	5.1	0.3
Terms of Trade % Change	0.2	-0.8	-2.2	-2.6	-2.2	-1.0	-3.6	1.0	2.4	2.8
Trade in non-convertible currencies	-1.1	-3.9	-3.2	-2.7	-2.1	-0.7	-0.3	3.0	3.3	3.7
Trade in convertible currencies	1.4	2.2	-1.1	-2.4	-2.4	-2.1	-7.1	-0.1	-1.8	2.2

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

HUNGARY

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	9.1	4.6	6.9	7.3	8.3	7.0	5.3	8.6	15.5	18.8
Fiscal Deficit (-)/Surplus as a % of GDP	--	--	--	--	--	-1.3	-4.2	-2.8	-0.7	-2.9
Investment Share of GDP %	29.6	26.8	25.4	25.0	23.7	23.2	23.8	24.1	20.6	19.9
Savings[2] Share of GDP %	1.3	1.9	1.8	2.1	2.2	2.5	3.2	1.6	2.5	1.1
Unemployment %	--	--	--	--	--	--	--	--	--	0.1
Real Wage Index 1980=100	100.0	101.1	100.4	97.2	94.9	96.1	97.9	97.5	92.7	93.5
Government Share[3] in Economy %	--	--	--	--	--	61.2	62.6	62.0	63.7	62.4
Investment in SOEs[4] as % of Total Investments	22.8	20.0	18.3	17.8	16.5	16.2	16.4	16.8	14.1	13.6
Gross New Foreign Investment (US mn$)	--	--	--	--	--	--	--	--	--	--

[1] At official exchange rates.
[2] Annual increment in households' gross saving.
[3] Budgetary expenditures as % of GDP.
[4] State-owned enterprises only (without cooperatives).

Sources: Central Statistical Office of Hungary.
National Bank of Hungary.
The Economist Intelligence Unit.

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

POLAND

POLAND

General Assessment of Reform

- **Poland's economic reform is a radical, shock-style restructuring.** It is no less than a comprehensive process of replacing a command economy with one in which the market is the central driver. The reform was put in motion at one go from January 1, 1990. On that date, Polish officials set in motion a wide range of measures designed to achieve secure short-term stabilization and adjustment, while paving the way for broader, structural change in the economy. Still ahead is the full development of an institutional infrastructure (banking, exchanges, insurance, accounting and auditing, anti-monopolistic authorities, tax system, etc.), a change in ownership structure and proper definition of property rights.

- **"The Balcerowicz Plan" was driven by both external and internal forces.** The program was, to some extent, influenced by Western experts (notably Jeffrey Sachs of the U.S.) as well as by the experience of stabilization programs in other countries (for instance Israel). But on the whole, it grew out of Poland's own resolve not to repeat the mistakes of past half-hearted, ill-conceived and gradualistic reform efforts. The Polish people understand it as an indigenous undertaking.

- **The January 1, 1990 stabilization measures implemented were unquestionably hard-hitting— much harder than generally anticipated.** Prices were hiked dramatically starting in January and continued rising steadily over the course of the year. Monetary growth was tightly repressed; the money supply increased in the first half of the year by 42 percent against a 170 percent increase in prices— a substantial reduction in real terms. Interest rates shot up. Government spending was cut to the extent that officials more than met, by mid-year, their goal of a balanced budget.

- **The recessionary impact of these shock measures on the economy was harsh.** Industrial output fell by around a quarter in the plan's first year. High interest rates and huge state budget cuts ruled out many expansion plans. However, there is no question that the plan had extremely high short-term adjustment costs. Consumer demand fell sharply. Sales of agricultural produce, as measured by those of meat and milk, showed a decline of 10-15 percent over the three quarters of 1990. For the year,

real wages were estimated to have fallen by 28 percent and total consumption by 30 percent. The number of unemployed reportedly hit or exceeded 1 million— that is, some 9 percent of the work force, by the end of 1990.

- **The painful short-term adjustment costs were not missed by the government.** In fact, in mid-1990, after the first wave of stabilization measures had registered an impact, there is evidence that fiscal, monetary, and wage policies were eased to avert a sharper contraction in demand and a possible political backlash to reform. This was particularly important as the November presidential vote approached.

- **Poland's traders responded favorably to changing market conditions.** Hard currency exports rose by more than 30 percent in 1990 alone. Propelling that growth was the highly undervalued exchange rate and the fact that austerity measures had practically dried up domestic demand. In addition, Poland's exports enjoyed easier access to the European Community and other hard currency markets.

- **The transformation of ownership in Poland has begun. It is one of, if not the most crucial, elements in the reform process.** True market-based reform will require a fundamental change in the notion of property rights, away from the almost total dominance of the state (at least in the nonagricutural sector). Privatization in Poland, as elsewhere, must proceed on two fronts. The first is "privatization from below"— an expansion of the existing, and establishment of new, private firms. This requires lifting the former restrictions, which was done in Poland in 1990, both for domestic enterprises and for joint-ventures or fully foreign-owned firms. The lifting of restrictions, however, is not tantamount to abolition in practice of all kinds of bureaucratic barriers, and certainly not to creating sufficiently favorable enabling conditions.

- **The process of "privatization from above"— transforming state-owned assets into individual (or collective) property through sale or in other forms— is still in its infancy.** With respect to small services and retail trade, privatization took off in Poland in 1990 on a rather large scale. It is estimated that some 10,000 retail shops have passed into private hands in the first half of 1990; the number was expected to grow by 70,000 in the second half of the year, which would imply privatization of 70 percent of retail outlets previously state-owned. With regard to the main bulk of state-owned industry, the issue proved to be— unsurprisingly— very complicated. On the

strictly economic side the main problem is the valuation of assets, which is difficult under any conditions, but especially so in the absence of a functioning capital market. Legal, social and political aspects present another cluster of formidable hurdles.

- **Poland needs substantial external support to achieve sustained economic reform and recovery.** On the positive side, continuation along the current reform path will assure that it continues to receive IMF and World Bank support. Also in March 1991, creditor governments (Paris Club) agreed to forgive 50 percent of Poland's debt it holds. The U.S. government then pledged to forgive some 70 percent of Polish debt on its books. Poland's debt overhang remains enormous. The nation's reform objectives of stabilization, marketization and restructuring are unlikely to be achieved without substantial external help. Poland's Finance Minister Leszek Balcerowicz maintains that the nation's external debt needs to be reduced by 80 percent to assure ongoing economic reform and political stability. Indeed, concern is widespread that a continued decline in domestic consumption will turn labor and key groups within the government against the reform program.

I. Background to Reform

The idea of a market-oriented reform of the economic system was present in one form or another in Poland since the second half of the 1950s, with reformist activity by the government especially pronounced after violent outbursts of popular discontent (1956 and 1970). Neither of these reforms was successful in any real transformation of the economic system. The same was true of the reform attempts in the 1980s, after the emergence of the powerful "Solidarity" movement. The Communist government of General Jaruzelski came out with an economic reform program two weeks after subjecting the country to martial law: From January 1, 1982, many economic decisionmaking powers were to be devolved to enterprises (with mandatory targets abolished), which were to be endowed with the "Three S" (self-dependent, self-managed, self-financing). The introduction of the supposedly new system was accompanied by a stabilization plan aimed at curbing and then reversing the fall in national product. The latter succeeded temporarily, but without reforming the economic mechanism, which remained basically unchanged.

The failure to improve efficiency soon started to threaten the recovery, and the need to launch a "second stage" of economic

reform (January 1, 1988) was acknowledged. This time the change in the "rules of the game" were to be prepared and supported by a wide-ranging price reform. In practice, the latter proved to be the almost sole component of the "second stage": prices rose at least by 40 percent on average, without becoming subject to actual supply-and-demand conditions.

The last Communist government, already facing defeat under new political circumstances, took the desperate step to de-control ("marketize") the production and distribution of foodstuffs from August 1, 1989, preceding this by a monthly freeze of prices and wages. The result was virtual chaos: near hyperinflation, an overvaluation of the zloty, widespread shortages, and a sharp deterioration in the trade account.

The Tadeusz Mazowiecki government, which took over in September 1989, was Central and Eastern Europe's first non-Communist regime in decades. The new government devoted itself in the last three months of 1989 to halting the economic decline, thus setting the stage for the launch of the so-called "Balcerowicz Plan" (named after the vice-premier and finance minister in the new government, Leszek Balcerowicz). The Mazowiecki adjustment measures mark the start of Poland's march down the road of structural economic reform, a process which was greatly broadened and accelerated with the launching of the Balcerowicz Plan on January 1, 1990.

II. Evolution and Chronology of Poland's Economic Reform

1980

The economic and sociopolitical crisis comes to the fore in a wave of strikes in the summer of 1980, culminating in the Gdansk Accords in August. Formation of the Independent Self-Governing Trade Union "Solidarity."

"PUWP" September— the Central Committee of the Polish United Workers Party (PUWP) creates a special Commission for the Preparation of Economic Reform.

1981

July— document "Directions of Economic Reform" adopted by IX Congress of PUWP.

September/October— First Congress of "Solidarity" which expands into a 10-million strong popular movement. Program of "Solidarity" includes general reform-ideas more radical than the "Directions", but fails to adopt a single reform blueprint.

December — martial law imposed on Poland. Delegalization of "Solidarity."

1982

Beginning of implementation of "Directions of Economic Reform" proclaimed by the Martial Law government. State enterprises are to become self-dependent, self-financing and self-managed (the 3 "S's"). State planning and management organs are to use indirect regulatory instruments (monetary, fiscal, pricing, incomes policies) instead of commands. Enterprises can apply for the right of direct access to foreign trade.

Prices are to be divided into three categories: fixed, regulated (according to rules of cost calculation), and contractual (free). Foreign currency retention quotas introduced for exporting firms.

July — small foreign private firms established by Polish expatriates ("Polonia enterprises") authorized.

1983

Introduction of government contracts (orders), often as a substitute for former obligatory targets.

Replacement of average wage by the wage bill as basis for taxing the enterprises' remuneration fund.

1984

Progressive tax on enterprises' profit replaced by linear tax of 60 percent.

1985

By the end of the year, only 102 firms succeeded in getting a license for foreign trade.

Successive devaluations of Polish currency (zloty). The target of making three-quarters of all exporters profitable is not achieved (the actual figure 62 percent).

1986

Joint ventures with foreign capital admitted by law.

State enterprises authorized to issue bonds.

1987

Export Development Bank established with the right to grant credits in foreign currency.

A single Ministry of Industry replaces branch ministries.

In view of the failure of reform attempts hitherto, plan for a "second stage of economic reform" submitted to a nationwide referendum. The "accelerated" version of the plan fails to get approval.

1988

From the beginning of the year, prices (government controlled) increase on average by 40 percent (foodstuffs 27 percent, fuel and energy 100 percent) with partial monetary compensation. Government reshuffle occurs as a result of the failure of the "price-income operation" to achieve its anti-inflationary objectives. The new government (the last Communist government in Poland) again promises stabilization and reform.

January— The Bank Law establishes a two-tier banking system; the Polish National Bank is to become a standard central bank operation along with the expanding network of commercial banks.

December— The Law on Economic Activity proclaiming the principle of equality of all ownership sectors (inter alia restrictions lifted on founding and size of private enterprises). The Law on Economic Activity with Foreign Participation (replacing the 1986 Joint Venture Act) creates tax advantages, eases profit repatriation procedures, and lifts the limit on the share of foreign capital.

1989

In January, new custom tariff based on GATT definitions is introduced.

The Currency Law legalizes foreign currency transactions among Polish residents and gives the exporters the right of ownership of their foreign currency revenues.

Gradual devaluation of the Polish zloty.

In August, ill-prepared deregulation of most consumer goods prices (including food) results in virtual explosion of overt inflation, rapidly spreading shortages, and overall economic chaos.

In September, a "Solidarity" dominated government, the first non-Communist administration in Central and Eastern Europe, takes over.

1990

New government implements radical economic shock plan:

Price controls are lifted. All prices are freed to find their level in the marketplace except for a handful of basic necessities (e.g., bread, milk, fuel, transportation fees, rents, etc.).

However, controlled energy prices are increased by 300-600 percent to cover the average branch costs plus a markup:

Coal, coke, and electricity prices for industry are liberalized on July 1, 1990.

A uniform exchange rate of the zloty is introduced: Z9500:$1:

This represents a substantial devaluation. Currency exchange rate approaches the free market level.
The zloty becomes internally convertible— i.e., individuals and resident firms (whether domestically owned, joint-ventures, or foreign-owned) have the right to exchange foreign currency for zlotys.
Resident exporters are put under an obligation to sell their earnings in foreign currency to Polish banks.
National Bank monitors the spread between the rates offered by the banks and by the private exchange bureaus, and is empowered to intervene if the spread became too large, using the standby facilities provided by the IMF.
The new exchange regime applies to the current account only, and not to capital movements.

Most quantitative restrictions on imports are eliminated and a uniform customs tariff is introduced:

Restrictions on exports are greater, mainly in order to prevent re-exportation of some commodities imported on special arrangements with CMEA countries. Nevertheless, the degree of liberalization is substantial.

The credit system undergoes a fundamental change:

The National Bank of Poland begins in practice to function as a central bank, while the functions of credit and deposit-taking are shifted to a network of commercial banking institutions.

This spells an end to "soft" credit, which in the past was designed to support plans formulated as physical targets, and to bail out enterprises in difficulties.
Interest rates are raised dramatically, both in order to enforce financial discipline, and to attract savings.
Uniform interest rates become applicable throughout the economy with only a few exceptions later in the year (agriculture).
The National Bank is charged with the task of keeping growth of the money supply below inflation.

The budget deficit is to be curbed, and later eliminated, by measures also to some extent connected with systemic changes:

On the expenditure side, this was to be achieved by a drastic reduction in subsidies to industry (some 8 percent of GDP).
On the revenue side, an increase in the share of industrial taxes in GDP is planned.

Wage growth is to be limited by a straightforward austerity measure— the punitive (up to 500 percent) taxation of wage payments exceeding an established norm:

Average wage increases in the first quarter of 1990 are fixed well below the anticipated rise in the consumer price level (for January, 20 percent against the expected 45 percent increase in prices). Along with the fall in inflation, this gap was to be gradually narrowed, but not fully eliminated. Thus, the imposed reduction of real wages constituted a substantial "nonsystematic" element in the stabilization plan.

Key institutional reform measures related to structural economic change are undertaken in 1990 and early 1991:

Capital markets: Issuance of bonds (both private and government flotations), as well as formation of the first joint-stock companies, which start to sell shares on subscription. The banking system (commercial banks) starts to act as a financial intermediary in capital movements, although on a limited scale due to the rather low level of new investment activity. The opening of a stock exchange planned for 1990 is postponed to mid-1991.

Tax reform: A comprehensive reform of the budget and tax system is prepared in 1990 for introduction at the start of 1991. The new tax system is to change indirect taxation to a VAT principle (with three levels of rates); generally apply a

progressive personal income tax; and simultaneously introduce a new local tax system. The task proved too demanding, however, and the tax revolution had to be delayed for a year. In 1990 only partial modification of the existing system was carried out.

Competition: A number of anti-monopolistic measures are introduced with scant success. The problem is very important because of the extremely high rate of monopolization in industry and in the distribution sphere inherited from the command economy. The new government managed to break up the bureaucratized structures of the hierarchically organized cooperative conglomerates which in actual fact were state monopolies in economic relations with agriculture; a few industrial conglomerates have also been broken up, but most of them still remain. In mid-1990 an Anti-Monopoly Bureau was formed as a watchdog with considerable formal powers. Reductions of import tariffs from July 1, 1990, were also to serve as a competition-strengthening factor on the domestic market.

Labor: The network of labor exchanges is strengthened and their functions extended in order to facilitate reallocation of the work force and to deal with the social aspects of unemployment— a new phenomenon in Poland. (A system of unemployment benefits was established, soon to be modified in accordance with accumulated experience.)

Private property: The transformation of ownership structure of the economy has begun. This is one of the key issues of the entire process. Consistent marketization requires a fundamental change in the system of property rights— away from the almost total dominance (except, in the Polish case, agriculture) of ill-defined state ownership.

Privatization: On July 13, 1990, the Polish Parliament (Sejm) passes the Act of Privatization of State-Owned Enterprises, which sets out the general principles of the process, but still leaves much to further legislation or executive orders, with the newly established office of the Minister of Ownership Changes in charge of implementation.

Two options for the disposing of state-owned assets are established: straightforward sale (or lease) of assets of an enterprise which is being wound-up fully or partly, and— the main road— through the process of

transformation of a state-owned enterprise in the present form into a joint-stock company.

Seven large enterprises were due to be transformed into joint-stock companies before the end of 1990. A further 38 large and medium companies are being prepared for privatization at the beginning of 1991; by mid-1991 the process should accelerate substantially, and it is hoped that at that time also the stock exchange will start to function.

In November/December 1990 the first attempt was made to sell shares in five companies on subscription: out of these, the share offer was oversubscribed in one case, the entire offer was taken up after several weeks in another, and in three cases demand fell at first around 40 percent short of the value of the capital offered for sale; the enterprises were finally sold in January 1991.

Paris Club agrees to postpone payments of interest and principal until March 1991. Project loans and credit guarantee commitments for the year approach $10 billion, but Poland is able to utilize only about 10 percent of these, due to a shortage of suitable projects.

Solidarity labor leader Lech Walesa wins presidential election on a platform of "accelerated change."

III. Analysis of the Reforms

A. Timing

- **The so-called "Balcerowicz Plan" was a sudden and complete shock plan.** It was made possible by the political situation after the massive electoral victory of "Solidarity" (June 1989), and the subsequent rapid disintegration of the Communist party and state apparatus which began in Poland before the 1989 revolution in other East European countries.

- **In important ways, the international backdrop for Poland's reform efforts is less favorable today than when the country began the reform process.** First, when the new government took over in late 1989, Poland (together with Hungary) was clearly in the vanguard of change, and could count on some sort of special treatment both in terms of political attention and economic aid from the West. The spread of the revolution

deprived Poland, along with Hungary, of the uniqueness of its position, particularly with Germany focusing on the economic consequences of reunification. Among other things, this may have been a factor in the disappointing levels of private foreign capital into Poland, although internal obstacles are probably more important. Second, the heavy burden of foreign debt still overshadows the prospects of the Polish economy, and little progress has been made toward a long-term solution. Third, the disintegration of the CMEA, and especially the severe cuts in Soviet supplies of oil, gas and raw materials (despite binding agreements for 1990), have seriously compounded the difficulties of the Polish economy. Fourth, the direct and indirect consequences of the Gulf crisis are estimated to have cost Poland about $3 billion in 1990 alone.

B. Sequencing

- **The Tadeusz Mazowiecki government, which took over in September 1989, set the stage for the shock measures contained in the so-called Balcerowicz Plan.** The Mazowiecki regime, the first non-Communist government in Central and Eastern Europe in decades, enjoyed popular trust and was thus able to push through important measures to stabilize the economy and avert hyperinflation. Key measures included a slowdown in wage increases, reduction of the budget deficit, a tightening of credit and continuous devaluation of the zloty exchange rate (vis-à-vis convertible currencies). These measures registered some success. Inflation and wage growth slowed down considerably in the last two months of the year.

- **Stabilization remained the central focus of the first phase of the Balcerowicz Plan, at least in the immediate term.** But the policy choices made were anything but moderate. All at once, prices were radically freed; the exchange rate was substantially devalued; trade was liberalized; banking reform was started; subsidies to industry were cut and fiscal disincentives were created to curb wage hikes.

- **The second reform phase was geared toward institutional and "structural" change.** In particular, authorities began work toward reform of the budget and taxation systems, capital markets, antimonopoly regulations and the like. This process continues to evolve in the reform program's second year.

Structural Reform Matrix (SRM)
Worksheet for Poland

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1988		Reform Period 1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	50%	3.0	80%	4.8
		No Local Content Regulations	4	60%	2.4	80%	3.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	80%	7.2
		Minimal Exchange Controls	5	20%	1.0	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	20%	1.4	70%	4.9
		Minimal Preferential Interest Rates	1	40%	0.4	70%	0.7
		Equal Access to Capital	3	20%	0.6	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	80%	5.6
		Minimal Subsidies	4	40%	1.6	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	90%	5.4
		Reduced Marginal Tax Rate	2	20%	0.4	30%	0.6
		Equitable / Uniform Tax Collection	2	10%	0.2	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	00%	0.0	30%	1.5
		Franchise Out State Services	2	00%	0.0	20%	0.4
		Simulated Privatization	3	10%	0.3	60%	1.8
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	50%	3.0
		Proactive Promotion	1	20%	0.2	50%	0.5
2	Information	Free Flow of Market Information	2	40%	0.8	70%	1.4
16	Enabling Environment	Private Property Rights	9	20%	1.8	40%	3.6
		Efficient Gov. Administration	2	50%	1.0	70%	1.4
		Legal and Accounting System	2	30%	0.6	60%	1.2
		Infrastructure	3	30%	0.9	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	27.4	28.3	61.7	65.2

POLAND

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real GDP Growth	--	-10.0	-4.8	5.6	5.6	3.6	4.2	2.0	4.1	0.5
By sector: Agriculture	--	-0.5	5.7	5.2	5.7	1.1	5.2	-6.8	1.1	2.0
Industry[1]	--	-13.7	-3.8	5.6	5.1	3.8	4.3	3.2	4.8	-3.4
Services	--	8.9	-3.7	3.0	7.4	2.4	3.4	0.8	--	--
Construction	--	-14.7	-8.5	7.0	7.7	4.1	3.9	2.1	6.2	-8.9
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100										
Purchasing Index, US=100										
EXTERNAL TRADE AND BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports	19.12	15.53	10.25	10.60	10.65	10.84	11.21	10.85	12.24	11.30
Exports	17.02	13.29	11.22	11.58	11.76	11.49	12.07	12.21	13.96	12.86
Current Account[1]	-2.7	-3.1	-2.2	-1.2	-0.7	-0.5	-0.6	-0.4	-0.6	-1.9
Capital Account	--	--	--	--	--	-2.32	-3.35	-3.16	-3.57	-2.83
Changes in Reserves	--	--	--	--	--	0.24	0.17	-0.8	-0.56	-0.04
External Debt[1]	23.5	25.1	25.3	25.2	25.4	27.7	31.8	36.2	35.6	36.5
Interest Payments on Foreign Debt[2]	2.3	2.9	3.0	2.7	2.5	2.4	2.6	2.8	2.9	3.1
Export Growth %[2]	-4.2	-19.0	8.7	10.3	9.5	1.3	4.9	4.8	9.1	-0.7
Terms of Trade % Change[3]	--	-0.9	2.4	-5.7	-1.4	5.2	1.4	0.7	0.7	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

POLAND

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation %	--	21.2	104.5	21.4	14.8	15.0	17.5	25.3	61.3	400.0
Fiscal Deficit - Share of GDP[4]	--	--	--	--	--	1.22	1.17	1.63	1.08	--
Investment - Share of GDP %[5]	17.3	20.0	17.9	18.6	19.8	21.1	21.1	21.6	--	--
Savings - Share of GDP %[6]	--	--	--	--	--	16.7	16.3	15.0	14.8	400.0
Unemployment	--	--	--	--	--	--	--	--	--	--
Real Wage Index 1980 = 100	--	102.3	76.7	77.6	78.1	81.1	83.2	80.3	91.9	102.5
Government Share in Economy %[7]	--	--	--	--	--	81.3	81.0	82.2	81.9	--
Investment in SOEs[8]	--	--	--	--	--	81.9	82.5	82.6	83.0	--

[1] In convertible currencies only.
[2] Constant prices.
[3] Non-socialist trade only.
[4] Central budget deficit.
[5] Gross investment in constant prices relative to GDP for years 1985-87, and to net material product for other years.
[6] Household savings in relation to GDP, in current prices.
[7] Public sector's share of NMP in constant prices.
[8] Public sector's share in total investment outlays, current prices.

Sources: Polish Statistical Yearbook, 1989.
Zycie Gospodarcze, 1990.
ECE Economic Survey of Europe, 1989-90.

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

SOVIET UNION

Prepared for the Center for International Private Enterprise

THE SOVIET UNION

General Assessment of Reform

- **Mikhail Gorbachev's economic reform concepts were radical.** Prior to this, the Soviet leadership attempted limited reforms—promoting technology diffusion and quality, for example—without taking the decisive leap of embracing a market-based system. Under Gorbachev's leadership, a strong consensus developed among all key economic and political stakeholders that the market mechanism had to play a significantly greater role. But fundamental disagreements existed about the proper extent, depth and pace of "marketization." These disagreements surfaced with the unveiling of the radical 500-Day Plan, which threatened conservative forces resistant to change. The hardliners' anti-reform pressure on Gorbachev effectively destroyed the 500-Day strategy. A compromise plan was passed in its place. Doubts over the viability of market-based structural reform in the current Soviet environment are now widespread.

- **The scope of reform was broad, but actual policy implementation was incremental.** Among key objectives were general decentralization (except for heavy industry), state enterprise self-financing, a more market-sensitive system of prices, more effective work incentives, select privatization, support of foreign trade, a convertible rouble, and a reform of the banking system. A noted shortcoming of Gorbachev's reform efforts was the absence of an overreaching reform strategy and plan. Basic internal disagreement over the extent and sequencing prevented this. As a result, moves toward a market economy were incremental.

- **Gorbachev has enjoyed more formal political power than any other Soviet leader,** since acquiring the title of president (resembling the French and U.S. styles of presidency). At the same time, however, Gorbachev has seen his political authority crumble. Domestically, he encountered strong resistance from the Communist Party bureaucracy, which clearly had much to lose from the political and economic changes planned. Gorbachev, it has been observed, tried going over the heads of the bureaucracy, to appeal directly to the Soviet people. Ultimately, he did not win an overwhelming vote of personal confidence and a clear mandate to stay the reform course. Without that, he was vulnerable to the challenge of the popular Russian president Boris Yeltsin for accelerated reform on the

one hand, and pressure from the old guard on the other. In the end, Gorbachev sided with the hard-liners.

- **Democratization and political liberalization initially helped propel the economic reform movement forward. Later, these forces indirectly helped undermine economic reform.** The political opening was sudden and vast, and it provided an important platform for new and radical ideas and critiques to be heard, debated, and carried forward. At the same time, the political opening loosened the control of the leadership over the center and the regions. The new freedom gave rise to the separatist conflicts, which threaten the implementation of the reform program and call into question the future of the Soviet Union itself.

- **Many Soviet watchers doubt that Gorbachev will resurrect the full-scale economic reform agenda.** Indeed, while some reform plans have gone forward, authorities have backtracked on reform. The January 1991 "rouble crackdown," in which savings accounts were partly frozen and all 50- and 100-rouble notes were banned, was interpreted as a revealing event — evidence that Gorbachev is reasserting a traditional Soviet bias against private initiative.

- **Soviet economic performance since liberalization began, has not been a reform-reinforcing factor.** National income was estimated to have fallen 3 percent in 1990, with productivity down 2 percent. The Soviet Union's balance of payments are in a highly weakened state, with current account deficits for 1990 and 1991 estimated to be in the $10-15 billion range. Public investment plans have fallen seriously behind targets.

- **Reform has contributed to acute hardship at the consumer level.** Shortages of consumer products have been widespread and prices of many basic goods have risen rapidly, even though prices on many other goods remain controlled. Consumer hardship has bred resentment and resistance at the republic levels, to the point where some price increase orders have not been implemented. The Soviet economy, in retrospect, was structurally unprepared to respond to broad-based liberalization. Consumers felt the crunch of higher prices without the benefit of increased competition, which would evolve more slowly over time.

- **The Soviet Union has failed to deliver a clear, consistent message in favor of foreign investment.** The legal and regulatory framework for foreign investment is still considered

seriously undeveloped. The rules of the game are criticized for not being clear, and often contradictory.

I. Background to Reform

The Soviet economy has been highly centrally planned since the late 1920s. Although the mobilization of resources under such directives transformed a predominantly agricultural economy into an industrial one, the resulting industrial structure has proved increasingly less able to cope with the demands placed on it by its own internal plans, and by the aspirations of its inhabitants to higher living standards. The Soviet Union has in its industrialization, exploited its demographic growth and huge mineral and energy resources to develop in a pattern best described as "extensive," that is, dependent on increased inputs for higher output, rather than more efficient (or "intensive") use of these inputs. The incremental labor input has been exhausted, and the readily accessible resources have been depleted in many places with widespread environmental damage.

There have been attempts at piecemeal reforms of the Soviet planned economy since the mid-1950s, but those set in motion in 1987 by the Law on the State Enterprise are more widespread and fundamental than any yet considered. The original program bore a passing resemblance to the 1965 Kosygin reforms, but differs in that the current government is committed to systemic change. Advance indicators of perestroika can be identified as far back as 1983 when General Secretary Andropov castigated the shortcomings of the system, but these indicators were stifled by his successor. Gorbachev's accession put economic reform back on the agenda, with a few marginal reforms put in place before the unveiling of the main program in 1987.

II. Evolution and Chronology of Key Soviet Reform Events

1982

Death of Leonid Brezhnev; he is succeeded by Yuri Andropov.

1983

Andropov makes first moves toward opening up debate on economic reform; he also cracks down on corruption.

1984

Mikhail Gorbachev becomes communist party leader.

1987

Decrees on Foreign Trade, allowing joint ventures with CMEA partners. Simultaneously, bodies, other than the Ministry of Foreign Trade, are allowed to engage in trade.

Law on Individual Economic Activity:

Authorizes the existence of private enterprises, particularly in the services sector
State enterprise workers can engage in such activities on a part-time basis only.

Law on State Enterprise:

Comes into force for a limited number of enterprises on January 1, 1988 and for all enterprises on January 1, 1989
Law makes all enterprises "self-accounting" — they have to cover their spending from either income or borrowing
Enterprises no longer have to fulfil state plans; they are to be given "state orders," which are intended to be a decreasing part of total output, leaving a residual that they can sell at their discretion, albeit at state prices
Law also includes a more realistic basis for enterprise accounting
The Law on the State Enterprise does not have any immediate effect on production efficiency or output levels, mainly because the ministries reinterpret the Law in their own interest
The main result of the freedoms extended to enterprises is that wages grew far more rapidly than productivity, causing excess liquidity in the consumer sector and, ultimately, shortages of consumer goods (imports of which are cut back in response to the oil price fall).

Council of Ministers Decrees on prices, the banking system, and definition of powers of ministries.

Decree allowing joint ventures with non-CMEA countries, including capitalist ones.

1988

Law on the State Enterprise comes into effect.

Law on Co-operatives.

Postponement of price reform.

First admission of the existence of a State budget deficit.

All enterprises and co-operatives receive the right to engage in foreign trade, provided that their product is competitive in world markets, and subject to certain restrictions.

1989

New restrictions on prices— contract prices severely restricted, and co-operative prices curtailed.

Guidelines on republican economic independence, proposing considerable devolution of economic power.

First free elections during Soviet regime; many apparatchiki ousted.

Congress of People's Deputies:

Major constitutional changes
First publication of the existence of foreign debt
Abalkin becomes Deputy Prime Minister, with powers to plan a reform schedule.

Formation of State Committee for Economic Reform.

Supreme Soviet resolution on taxation of increases in the wage fund greater than 3 percent.

Amendments to Law on Co-operatives, further restricting prices, as well as tightening controls on contract prices.

First of a series of foreign-exchange auctions (open only to Soviet enterprises, not to joint ventures or individuals).

Prime Minister Ryzhkov presents new reform package to Second Congress of People's Deputies.

1990

Introduction of new wholesale tariffs for diesel oil, electricity, and transport (later nullified).

Draft Law on Land published:

Local Soviet and some Republican elections; new radical Parliaments elected.

Law on Property:

This, combined with Law on Land, goes considerable way toward legalizing private ownership of land and capital.

Third Congress of People's Deputies:

Constitutional changes include the creation of a Presidency.

Lithuania declares independence.

Boris Yeltsin becomes president of the Russian Republic.

New all-Union government economic reform plan is unveiled:

Calls for a five year transition period
Key points in first phase (1991-92) include price rises, construction of a social security safety net, and the creation of a property market
Second phase involved state sector reduction, anti-monopoly legislation, and enterprise incentives
Plan subject of widespread criticism— e.g., "shock without therapy"
Major criticism is heavy reliance on administered transition to the market; no pre-commitment to privatization
Rejection of government reform plan.

New Law on State Enterprises.

Gorbachev and Boris Yeltsin set up body to guide market reforms.

"500 Day", drawn up by Gorbachev economic aid Stanislav Shatalin, is debated but ultimately rejected by Parliament:

Plan had already been adopted by Russian Republic
Called for reform implementation at the republic level
Envisioned a period of stabilization and privatization of small business, followed by price deregulation and privatization of larger enterprises.

Gorbachev charged with coming up with his own plan. He announces "Basic Directions for the Transition to a Market Economy." It is a compromise strategy:

Drops the timetable of 500-Day Plan
Repeats call for privatization, relaxation of price controls

One-third of all prices (i.e., basic goods) would remain controlled until anti-monopoly measures and privatization took effect
Calls for wage indexation
Supreme Soviet gives go-ahead to plan, which is to be implemented by presidential decree.

Presidential decrees allowing foreigners to own 100 percent of enterprises based on USSR territory, and introducing new commercial exchange rate for the rouble and permitting joint ventures access to foreign-exchange auctions.

Decree on wholesale prices, putting 70 percent of these on contractual terms from April 1991, retaining control over the remaining 30 percent.

Publication of new Soviet tariff rates. Revisions based heavily on government revenue considerations. Some priority consumer goods are lowered; others are raised or kept at comparatively high levels. Tariffs on some basic consumer goods surprisingly high, at 1,500-2,000 percent.

Gorbachev announces further constitutional changes, to be ratified by the Congress of People's Deputies in December. More powers would be given to the republics.

Liberalization of the foreign exchange market:

From November 1990, there are three exchange rates set for the rouble:
the official exchange rate: 0.55 rouble to $1
the commercial exchange rate: 1.65 rouble to $1
the tourist (special) exchange rate: 5.51 rouble to $1

Russian Federation launches its own 500-day plan.

Foreign Minister Edward Shevardnadze, a key figure in the Soviet opening to the West, resigns.
A new Law on Banks passed; it is scheduled to go into effect in 1991

Will create an independent central bank
Government will have to compete with private borrowers for loans at market rates
Enterprises will have to compete equally for loans.

III. Analysis of the Reforms

A. Timing

- **In general the reform process has not been driven by events outside the Soviet Union**, with the exception of the constraint imposed by the 1986 oil price fall, the aftermath of the Plaza accords, and the restructuring of foreign trade that will be necessitated by the break-up of the CMEA.

- **Pressure for political change in the Soviet Union has greatly complicated the economic reform process.** Although republican separatism and democratization have helped Gorbachev by enabling him to pull the more conservative forces towards marketization, they have also been costly, in terms of time, resources, and in some cases, human life. Since 1990, Gorbachev has not had anything resembling a stable political environment in which to operate. The uprising in the Baltic republics was a body blow to perestroika.

- **The international perceptions of political instability (particularly since 1990) have hurt the Soviet Union's ability to attract new foreign investment.** Where this has hurt the Soviet economy the most is in the energy sector, which is vital to the nation's economic health and which desperately needs Western capital and technology to be rehabilitated. While the Soviets recognize this reality, they have not, it seems, implemented policies to consistently and clearly encourage foreign commitments. One widely noted disincentive is a new law calling for extremely high taxes on oil exports (40 percent).

B. Sequencing

- **Fiscal and monetary policy have been among the key shortcomings of the Soviet reform program.** It has only been in the reform period that the government has admitted it has a problem with fiscal and monetary policy, and so far the steps that have been taken to deal with it have been half-hearted. Cuts have been small, and the new democracy means that legislative bodies are more responsive to the demands of the electorate, and have passed a number of laws increasing spending without cutting back on other areas or raising revenue to compensate. 1990 was meant to be a year of austerity, but spending rises exceeded revenue increases by an order of magnitude. The government deficit is estimated at 10 percent of GDP for 1990. That ratio could double in 1991.

- **The process of privatization — broadly defined — has begun under Gorbachev, but as yet it has not progressed far.** There are two components of privatization: permitting a private sector to exist, and the sale of state-owned enterprises into private hands. The former was set in motion by the Law on Cooperatives in 1988, and more recently by the Law on Property and the Decree on Small Enterprises in 1990. Privately owned enterprises are now recognized and protected by the law.

- **The second component of privatization is not so far advanced.** Small-scale privatizations have taken place. For example, the Moscow, Leningrad, and Sverdlovsk local Soviets are selling off shops and restaurants, as are the Baltic Republics. There have been cases of employee buy-outs, but so far they have been few. Moreover, the demise of the 500-Day Plan puts in question chances for a new, viable privatization campaign. Significantly, the word denationalization is preferred, implying that although property will be transferred out of state hands, it may not necessarily be transferred to private ownership.

Structural Reform Matrix (SRM)
Worksheet for Soviet Union

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1986		Reform Period 1987-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	10%	0.9	30%	2.7
		Low and Uniform Tariff Barriers	6	20%	1.2	40%	2.4
		No Local Content Regulations	4	30%	1.2	40%	1.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	10%	0.9	40%	3.6
		Minimal Exchange Controls	5	10%	0.5	30%	1.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	10%	0.7	30%	2.1
		Minimal Preferential Interest Rates	1	20%	0.2	20%	0.2
		Equal Access to Capital	3	10%	0.3	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	10%	0.7	40%	2.8
		Minimal Subsidies	4	10%	0.4	40%	1.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	30%	1.8
		Reduced Marginal Tax Rate	2	40%	0.8	30%	0.6
		Equitable / Uniform Tax Collection	2	10%	0.2	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	00%	0.0	40%	2.0
		Franchice Out State Services	2	00%	0.0	30%	0.6
		Simulated Privatization	3	10%	0.3	40%	1.2
7	Foreign Investment	Non-Discriminatory Treatment	6	00%	0.0	30%	1.8
		Proactive Promotion	1	10%	0.1	40%	0.4
2	Information	Free Flow of Market Information	2	10%	0.2	40%	0.8
16	Enabling Environment	Private Property Rights	9	10%	0.9	40%	3.6
		Efficient Gov. Administration	2	10%	0.2	30%	0.6
		Legal and Accounting System	2	10%	0.2	20%	0.4
		Infrastructure	3	50%	1.5	30%	0.9
100	TOTAL SCORE/WEIGHTED - MEAN SCORE/UNWEIGHTED		100	13.9	12.6	33.5	34.7

SOVIET UNION

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
% Change in GDP	3.9	3.3	3.9	4.2	2.9	1.6	2.3	1.6	4.4	2.4
By sector: Agriculture	-1.9	-1.0	5.5	6.2	-0.1	0.1	5.4	-0.6	1.7	0.8
Industry	3.6	3.6	2.9	4.2	4.1	3.4	4.4	3.8	3.9	1.7
EXTERNAL TRADE ($bn except where stated)										
Convertible currency merchandise Exports	38.2	39.1	43.4	44.2	43.3	36.9	34.6	40.8	42.7	45.1
Convertible currency merchandise Imports	34.8	39.9	39.1	38.0	36.6	36.2	33.3	32.7	39.2	47.4
External Debt	25.2	29.0	28.4	26.9	25.6	31.4	37.4	40.2	41.7	50.6
Debt Service Ratio %	3.9	5.0	4.4	3.5	2.8	3.7	4.8	3.8	4.0	4.9
Export Growth (% on Previous Year)	1.6	1.9	4.5	3.3	2.5	-4.3	10.0	3.3	4.8	-0.3
Terms of Trade in East-West Trade (1975 = 100)	185.0	204.0	200.0	190.0	198.0	191.0	117.0	112.0	97.0	102.0
OTHER KEY INDICATORS										
Inflation (% Change in CPI)	0.7	1.4	3.4	0.7	-1.3	0.7	2.0	1.9	2.3	2.3
Fiscal Deficit (% of GDP)	--	--	--	--	--	2.3	6.0	6.9	10.3	9.9
Investment (% of GDP)	30.6	29.9	29.7	30.2	29.8	30.3	30.7	31.7	31.7	33.4
Savings Ratio (% of Money Incomes)	--	3.7[1]	3.7[1]	3.7[1]	3.7[1]	3.7[1]	5.1	5.3	6.1	7.2
Unemployment %	--	--	--	--	--	--	--	--	--	--
Real Wage Index (1980 = 100)	100.0	100.7	100.1	101.2	105.0	107.4	108.3	110.3	116.8	124.6
Government Expenditure as % of GDP	47.6	--	--	--	--	49.7	52.2	52.2	52.5	52.1
Share of Foreign Capital in Economy (%)	--	--	--	--	--	--	--	--	--	--

[1] Average figures 1981-85.

Sources: Economic Survey of Europe, Economic Bulletin for Europe, varous years (UN Economic Commission for Europe).
SSSR v Trsifrakh b 1989 godu (The USSR in figures in 1989), Moscow.
Finansy i Statistika, 1990.

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

BOLIVIA

BOLIVIA

General Assessment of Reform

- **Bolivia is Latin America's second poorest country. Its structural economic reform program grew out of one of the most extreme periods of economic crisis.** In 1984-85, Bolivian hyperinflation reached 24,000 percent -- one of the highest recorded anywhere this century. The government budget deficit in 1984 reached an incredible 27 percent of GDP. The government was almost completely bankrupt.

- **Bolivia's New Economic Program has been one of the most aggressive and hard-hitting in all of Latin America.** It was clearly no mere stabilization effort, but an intense multi-front economic restructuring along free-market lines. The main thrust of the effort was radical fiscal correction. Although hyperinflation was the clearest manifestation of the country's economic ills, the Bolivian program contained no price/wage control component. Some observers of the Bolivian experience make the point that price liberalization was a key part of not only the country's short-term stabilization strategy, but also its longer-term development plans.

- **The New Economic Program was launched without external funding firmly in hand.** Financial support from the major world financial organizations did not come until after the program was in effect for one year. This reflects the widespread skepticism that Bolivia would succeed in mounting a credible reform program.

- **The political success of the New Economic Program can be tied to the "Pact for Democracy" agreed to by President Paz and the top opposition political party.** While early measures were bitterly criticized and opposed by select labor groups, overall implementation has been peaceful and smooth.

- **The institutional cost of the fiscal reforms has not been insignificant.** Some analysts say budget cuts have resulted in a fall in the quality, as well as quantity, of bureaucrats. Meanwhile, recent press reports suggest that serious corruption and inefficiency continue to plague government administration.

- **The loss of the presidency in 1989 by the incumbent Revolutionary Nationalist Movement (MNR) did not derail the reform movement.** The banner of structural economic reform was then picked up by the two-party opposition coalition, whose policies reflect a strong degree of adherence to the reform ideal. The result is that Bolivia has enjoyed a high measure of policy continuity since 1985.

- **Falling union strength eroded opposition to the reform effort.** In particular, massive losses of tin mining jobs meant the end of a long history of sometime violent tin worker opposition to government austerity policies. Membership in other labor groups fell during the reform period also.

- **The macroeconomic results of the program have been impressive, despite less than ideal external circumstances.** Hyperinflation has been defeated. It has averaged around 16 percent on an annual basis since 1987— a truly remarkable achievement. Real GDP growth, while modest, is at least positive. One of the chief unfulfilled promises of the program has been the fact that Bolivia has yet to resume solid real per capita GDP growth. Poverty and its attendant social problems remain widespread.

- **Attracting foreign investment did not appear as a top government priority early in the reform process.** Significant foreign investment reform, in fact, did not occur until 1990. Some of the measures seem to have produced positive results. Since reopening its doors in 1990 to foreign capital for oil exploration and production, four new joint ventures involving multi-national companies have developed.

- **The coca industry undoubtedly played an important role in Bolivia's economic stabilization.** Coca (coca leaf production and export, as well as production of the refined coca paste) created an alternative source of foreign exchange and fueled the growth of a vibrant underground economy. Conservative estimates of the size of Bolivia's coca industry in the mid-1980s put it at around 13 percent of GDP. In recent years, there has been progress in cultivating alternative crops, but not yet on a large scale. Transportation bottlenecks remain considerable, and Bolivia lacks the capital or access to loans to finance upgrading of the infrastructure.

I. Background to Reform

After Haiti, Bolivia is the second poorest country in the Western Hemisphere. The Bolivian economy has historically been extremely dependent on a few mineral commodity exports. Tin and natural gas accounted for about 80 percent of "legal" exports during the decade of the 1980s. (Coca production and processing has evolved into an important illegal income source in recent years.) Bolivia has a tiny manufacturing base.

The debt crisis and acute political instability threw the Bolivian economy into a crisis state in the early 1980s. Starting in 1984, hyperinflation soared to record levels. In mid-1985, the new administration of Victor Paz Estenssoro initiated a massive stabilization program which in a few short years developed into one of the most hard-hitting structural reform programs in Latin America to date.

II. Evolution and Chronology of Bolivia's Economic Reform

1978-82

Period of acute political instability: Bolivia had 11 heads of state in this period including numerous civilian presidents and several military coups.

1979

Interim President Lydia Gueiler launches a tough austerity program to deal with the country's worsening situation but is overthrown the following year without the plan being able to take effect.

1980

Military seizes power and is universally condemned for corruption and repressive policies:

Bolivia begins to fall behind on repayment of its external obligations
Capital flight accelerates, reaching 10 percent of GDP in the 1980-81 period
IMF, World Bank and Inter-American Development Bank withdraw support.

1981-82

Onset of worldwide recession.

Three different military leaders fail to stem economic crisis. Hernan Siles Suazo, who had received a plurality in the stalemated 1980 elections, receives a four-year term of office.

1982-84

Domestic credit supply explodes, as capital inflows dry up. Inflation soars to 100 percent in 1982, 200 percent in 1983, and 1,300 percent in 1984.

1984

Siles Suazo government initiates orthodox stabilization program, but effort fails because of heavy labor opposition.

1985

Inflation reaches 24,000 percent. Final stabilization bid by Siles ends with a massive month-long labor action by tin miners. Elections are held in July, one year ahead of schedule.

New government of Victor Paz Estenssoro launches comprehensive stabilization program called the New Economic Policy. The following policies are successfully implemented before the end of the year:

Exchange rates are unified and foreign exchange is made freely convertible. (Exchange rate unification results in a 93 percent devaluation.)
Public sector prices raised to world levels
Ending of government regulation of private sector wages; restrictions on hiring and firing are terminated
Elimination of most price controls. (Retained are select controls on public transportation and utility prices.)
Public sector wages are frozen at three different times between August 1985 and December 1986
Government starts to reduce central government and public enterprise payrolls
Caps on commercial bank interest rates removed
Import quotas eliminated
Public sector deficit cut to 9 percent of GDP, from 27 percent the year before.

Price of tin collapses shortly after stabilization program is enacted.

Bolivia signs MIGA investment guarantee documents in bid for increased foreign investment.

Creation of Emergency Social Fund to mitigate adjustment effects via creation of labor- intensive employment in public works and provision of social services.

1986

World oil price crash; Argentina falls behind on gas purchase payments to Bolivia.

Tariffs unified at 20 percent (flat rate).
Tax reform:

- Rationalization of domestic tax rates
- Introduction of VAT, patrimony taxes.

Negotiation of IMF standby agreement ($58.5 million).

Rescheduling of Paris Club obligations ($400 million).

Bolivia wins an IMF compensatory finance facility ($75 million).

1987

New currency is introduced.

Sharp rise in public sector wage bill; Argentina falls behind on gas payments to Bolivia. Public sector deficit widens from 3.5 percent, to 8.9 percent of GDP.

New regulations passed aimed at strengthening the banking system and bolstering bank supervision.

1988

Fiscal policy is strengthened:

- Gasoline prices hiked
- Tax reform measures passed
- Expenditures decline in real terms
- Deficit falls to 5.5 percent of GDP.

Exchange rate is temporarily frozen, in response to an uptick in inflation.

GDP rises by nearly 3 percent, despite severe drought in agricultural sector; mining sector picks up after severe slump.

Second Paris Club restructuring ($390 million).

Bolivia finalizes repurchase of about half of its foreign debt, at the bargain rate of 11 cents to the dollar.

World Bank loan for $70 million to aid financial sector approved but disbursement delayed due to lack of credible data and management controls.

1989

An additional $140 million in commercial bank debt is retired.

A 24 percent salary increase awarded to public health workers and teachers.

No clear winner emerges from presidential vote, which ends up in a three-way tie. Two- party coalition government, led by Jaime Paz Zamora, results. Paz Zamora campaigned on a platform highly critical of predecessor's austerity policies, but does not reverse them once in office.

Markets stable by fourth quarter, once convinced that the Paz Zamora coalition government is not intent on reversing economic reform policies.

1990

Foreign investment rules liberalized:

Contains norms for guaranteeing investments.
Recognizes international agencies for dispute resolution
Bolivia reopens doors to foreign capital for oil exploration and production. Four new joint ventures are formed with multi-national energy companies.

Unemployment falls from 18 percent in 1988, to 9 percent.

Bolivia joins the GATT:

Reduces the general tariff from 15 percent to 10 percent.

Government frees interest rates, via auction system, for development loans refinanced by the Central Bank.

III. Analysis of the Reforms

A. Timing

- **The New Economic Policy (NEP) was launched under a new presidential administration, which was elected into office in an atmosphere of acute economic chaos and political uncertainty.** Among the key precipitating events was the rise in world interest rates in 1981-82, which raised Bolivia's debt burden to unmanageable proportions. Related to this was the fact that Bolivia was then cut off from new external borrowing. Hyperinflation grew uncontrolled. Uncertainty was endemic. Thus, President Paz enjoyed a clear mandate for change.

- **The New Economic Policy followed a string of failed reform attempts in the previous administration.** Credibility had to be established early, lest the program flounder. The intense and rapid nature of program implementation undoubtedly helped convince politicians, bureaucrats, business groups, and Bolivia's international creditors that the reform effort was serious and sustainable.

- **Bolivia experienced a severe decline in its terms of trade soon after the NEP was launched.** The fall was the equivalent of 3.8 percent of GDP. The key shock was the collapse of tin prices in 1985. The following year, Argentina began falling behind on gas payments, which accounted for about 40 percent of Bolivia's total export earnings. These two shocks prompted the government to undertake aggressive employment reduction in trade-dependent public enterprises, particularly the state mining company.

- **Mitigating the effects of the fall in the nation's "legal" terms of trade in the reform period, was heightened world demand for cocaine.** The coca industry, besides bringing in hard currency income, also fueled the growth of the informal economy, which evolved into an important source of employment in the 1980s.

- **The political success of the program can be tied to the "Pact for Democracy"** agreed to by President Paz and the top opposition

political party. The agreement created a congressional majority capable of pushing through the main points in the reform program. Importantly, the Pact ensured that the reform program went forward in a democratic context.

B. Sequencing

- **The two key stabilization measures implemented at the start of the NEP were the unification of the exchange rates and drastic fiscal reforms.** The exchange rate unification was accompanied by removal of all capital and exchange controls. Among the most powerful fiscal reforms were public sector price increases, a public sector wage freeze, and cutbacks in public investment spending and subsidies.

- **Liberalization of domestic interest rates and guarantee of full currency convertibility helped coax flight capital back.** This was particularly important in the first year of the reform program, before Bolivia had secured external funding from the IMF or World Bank.

- **Following the currency and fiscal reforms were tax reform and the reestablishment of relations with official creditor agencies.** By the following year, Bolivia had secured IMF and World Bank financing, and a Paris Club debt-renegotiation. The 1985 tax reform measures emphasized new taxes on consumption and wealth, rather than on profits and income. This approach was taken because of the rapid growth of the informal economy. The new tax system was based on a value-added tax.

- **Privatization has not been an integral part of Bolivia's structural reform efforts. However, financial reform of large state firms has been quite successful.** One explanation offered by some analysts as to why Bolivian authorities have not chosen the privatization path is because of the perception that corruption and mis-management frequently accompany divestments.

Structural Reform Matrix (SRM)
Worksheet for Bolivia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1984		Reform Period 1985-1989	
				Rating	Score	Rating	Score
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		Low and Uniform Tariff Barriers	6	40%	2.4	90%	5.4
		No Local Content Regulations	4	30%	1.2	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	90%	8.1
		Minimal Exchange Controls	5	30%	1.5	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	90%	6.3
		Minimal Preferential Interest Rates	1	30%	0.3	90%	0.9
		Equal Access to Capital	3	40%	1.2	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	90%	6.3
		Minimal Subsidies	4	40%	1.6	90%	3.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	70%	4.2
		Reduced Marginal Tax Rate	2	50%	1.0	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	40%	2.0
		Franchise Out State Services	2	30%	0.6	50%	1.0
		Simulated Privatization	3	30%	0.9	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	70%	4.2
		Proactive Promotion	1	40%	0.4	70%	0.7
2	Information	Free Flow of Market Information	2	40%	0.8	60%	1.2
16	Enabling Environment	Private Property Rights	9	70%	6.3	80%	7.2
		Efficient Gov. Administration	2	30%	0.6	50%	1.0
		Legal and Accounting System	2	50%	1.0	50%	1.0
		Infrastructure	3	40%	1.2	40%	1.2
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	37.8	38.2	70.4	75.8

BOLIVIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	-1.4	1.0	-4.3	-20.2	-0.3	-0.2	-2.9	2.2	2.7	2.5
By sector: Agriculture	1.5	-0.9	6.9	-16.4	22.9	9.1	-4.7	-0.2	-1.1	--
Industrial Activity	10.9	-3.1	-7.3	-4.0	-10.8	-10.8	-7.6	1.0	12.0	--
Services	-10.3	5.3	-6.4	-4.1	-1.0	3.0	0.9	3.9	-0.5	--
Per Cap. GNP-Current US $	490	540	540	490	450	410	420	490	570	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	13.41	11.95	10.69	8.49	9.14	8.27	8.05	7.44	6.83	6.22
Purchasing Index, US=100	67.52	88.49	82.15	109.37	140.68	68.98	108.67	117.48	127.84	140.20
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	0.66	0.92	0.60	0.62	0.52	0.58	0.69	0.71	0.51	--
Exports (fob) (1980 prices)	0.94	0.96	0.95	0.89	0.87	0.78	0.88	1.02	0.89	--
Current Account	-0.01	-0.47	-0.17	-0.14	-0.17	-0.28	-0.38	-0.43	-0.30	-0.26
Capital Account	-0.42	-0.02	-0.19	-0.26	0.05	-0.04	0.09	0.03	-0.08	--
Changes in Reserves	0.17	-0.02	-0.04	-0.05	-0.13	0.03	-0.10	0.08	0.04	0.13
External Debt	2.70	3.22	3.33	4.07	4.29	4.80	5.58	5.63	5.46	--
Interest Payments (on foreign debt)	0.16	0.17	0.18	0.17	0.21	0.16	0.10	0.08	0.09	0.16
Export Growth %	5.0	2.3	-1.5	-6.2	-2.4	-10.0	12.3	16.4	-12.5	--
Terms of Trade % Change	7.7	-5.5	-4.6	-1.5	-0.6	-4.4	-27.3	-17.7	12.8	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

BOLIVIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	47.2	28.6	133.3	269.0	1281.4	11749.6	276.3	14.6	16.0	--
Fiscal Deficit (-)/Surplus as a % of GDP	-7.36	-4.6	-19.0	-8.7	-28.4	--	-2.6	--	--	--
Investment Share of GDP %	14.7	16.8	12.4	12.5	11.9	12.7	5.6	6.4	10.5	--
Savings Share of GDP %	20.1	19.5	22.8	22.0	17.5	11.6	3.8	0.4	6.4	--
Unemployment %	5.8	9.7	10.5	14.2	15.1	18.0	20.0	21.5	24.0	--
Real Wage Index[1] 1980=100	100.0	96.0	111.0	99.0	122.0	--	-	--	--	--
Government Share in Economy %[2]	14.4	13.6	22.9	11.5	39.1	--	--	--	--	--
Gross New Foreign Investment (US mn$)	47.0	75.7	31.1	7.0	7.0	10.0	10.0	38.1	-10.1	-24.4

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

CHILE

CHILE

General Assessment of Reform

- **Chile's structural economic reform effort cannot be separated from the conservative ideological shift brought about by the military coup of 1973.** General Augusto Pinochet's economic goal was a dynamic, outward-looking free-market system that would prevent a return to Marxist politics. He pursued this with a single-minded commitment, despite sometimes severe policy mistakes and periodic changes in his economic cabinet.

- **There were two major periods of reform. The first began soon after the 1973 military coup and lasted through 1979.** The second commenced around 1985, after Chile had achieved sufficient stability following an acute financial and debt crisis in 1981-82.

- **Chile's structural economic reform drive has been vigorous.** It certainly has been the most ambitious in Latin America, and perhaps in all the developing world. It has included trade liberalization, price reform, privatization, foreign investment liberalization, financial market reform, and a general strengthening of private property rights. Major moves on all these fronts were made during the first few years of the military government and built upon after the mid-1980s.

- **Political and labor rights were greatly restricted and at times repressed during the military period.** Although the Pinochet revolution met little opposition initially, dissent was barely tolerated and often harshly repressed. Full democracy did not return to Chile until the 1989 election of Patricio Aylwin as president. The Aylwin government has thus far preserved the essence of structural reforms, but has sought to make economic policy more redistributive and responsive to popular needs.

- **Labor grew progressively weaker under the military government.** By the late 1980s, only about 10 percent of the labor force was unionized, compared to about 30 percent in 1975.

- **External conditions have not been wholly favorable to reform.** In the second half of the 1970s, the nation's terms of trade were highly negative, relative to the previous ten-year period. At the same time, windfall copper earnings in the late 1980s helped bolster the economy, especially the fiscal side, and reinforce the overall reform orientation.

- **Chile was denied strong developing country backing during its reform process.** Although the nation did receive IMF support along the way, the country's poor human rights record during the military period kept it internationally isolated. The U.S. deprived it of benefits under its Generalized System of Preferences program because of restrictions on union activity.

- **Chile made policy mistakes along the way that contributed to the crisis of 1982.** The most frequently cited are the decisions to go to a fixed exchange rate, the maintaining of a system of inflexible real wages, and the too-rapid liberalization of the internal financial market.

- **Chile's reform efforts have produced tangible results.** By the mid-1980s the country had achieved a high level of macroeconomic stability and was firmly on the road to recovery. Between 1985 and 1989, annual GDP growth averaged around 6 percent, and inflation was stable in the 20-25 percent range. Export growth averaged approximately 20 percent yearly during that period and unemployment fell from 12 to 5 percent. Importantly, real wages have climbed every year since 1985, although they are still at about 1981 levels.

- **Chile's economic reformers have received generally high grades as managers and policy implementers.** For example, the privatization campaign was greatly enhanced by the fact that the government help put these firms in order before trying to sell them off. Service tariffs were raised, subsidies were cut, and in some cases, employment rolls were cut prior to privatization.

I. Background to Reform

In 1973, a military junta led by General Augusto Pinochet overthrew the democratically elected government of Salvador Allende. Among the major impacts of the military coup was a radical transformation of the Chilean economy. The military takeover brought to an abrupt end the radical nationalist and socialist policies of the Allende era (1970-73), which included the nationalization of large enterprises, a dramatic increase in real

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wages, forced hiring of unemployed workers, and a generalized system of price controls.

Structural economic reform began soon after the military took power. Substantial changes were made in the 1974-78 period. Policy turned more expansionary starting in 1979, and in 1982 Chile was struck by an acute economic crisis. A period of stabilization followed. A second, and ultimately more profound, structural reform period began in 1984. The central objective of the reform program has been sustained economic growth through export promotion and progressive reduction of foreign debt requirements.

II. Evolution and Chronology of Chile's Economic Reform

1973-74

Military coup led by General Augusto Pinochet ends the nationalist/socialist economic program of Salvador Allende. Junta immediately begins a radical transformation of Chilean economy along free-market lines:

Drastic simplification of tariff system, with steady decrease in tariff rates
Major reductions in state spending.

1975

Fiscal situation registers dramatic improvement; deficit amounting to 22 percent of GDP transformed into a budget surplus of 1 percent.

World copper prices fall.

1977

Law 600 is enacted, guaranteeing foreign investors equal treatment vis-à-vis local companies. Foreign companies also guaranteed access to foreign exchange for remittance purposes.

1979

Expansionary period begins.

Major shift in exchange rate policy: After a devaluation, Chilean peso is fixed to the dollar.

Monetary policy relaxed; domestic credit supply expands.

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Cost-of-living wage adjustment system initiated.

Foreign borrowing increases substantially.

1981

Privatization of the social security system:

State administered civil pension funds transformed into a system of privately administered and capitalized pension funds.

Rising international interest rates contribute to a large current account deficit.

Foreign creditors cut off new lending.

Chain reaction of bankruptcies rock financial sector.

1982

International copper prices plummet.

Severe depression sets in; GDP falls 14 percent.

Emergency stabilization measures introduced:

Fixed exchange rate ends
Peso undergoes series of devaluations
Government rescues ailing banks.

1983

Foreign debts re-negotiated.

Standby agreement with IMF negotiated.

1984

Officials devalue peso by 19 percent in response to low copper prices and falling revenues.

Import duties raised from 20 to 35 percent across-the-board.

Customs duty-rebate scheme introduced to compensate exporters for higher tariffs on imported components.

"Popular Capitalism" plan unveiled to open ownership of re-privatized banks to individual shareholders.

1985

Major earthquake hits Chile, with losses amounting to about $1.8 billion (the equivalent of six months' export earnings).

Average import tariffs reduced from 35 to 30 percent.

Peso devalued by 9 percent to boost export sector; daily mini-devaluations continue in line with inflation differentials.

Proposed law to set reference prices for basic goods turned back.

Start of debt-for-equity swap (*pagare*) program.

Foreign investment rules liberalized:

- Restrictions on use of export receipts eased
- Capital remittance terms liberalized
- Taxation rates on new investments guaranteed for 20 years
- Allowable lead times on new ventures extended from 8 to 12 years.

Government spending for the year falls in real terms; deficit held to 3.5 percent of GDP.

1986

Trading of peso futures authorized.

Tariff protection for automobile vehicle assembly kits cut from 40-60 percent to a uniform 35 percent.

Benefits for temporary imports expanded.

Public sector deficit falls to 2.2 percent of GDP.

1987

Start of new privatization campaign involving traditional state-owned enterprises including electricity, telephone, telecommunications, and the national airline:

Corfo, the state development corporation, announces plans to sell up to 30 percent of its stock in a wide range of large state companies.

Authorization of foreign participation in select mining activities of Codelco, the state copper company.

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Authorization of offshore mutual funds to attract new sources of foreign capital.

Bank reform law passed, attenuating direct state involvement in the sector but leaving the government's supervisory powers intact.

Corporate tax rates revamped, to be made more competitive with international rates:

Tax on foreign profits remittances cut from 40 to 32 percent
Tax on insurance premiums to nondomiciled insurers cut from 40 to 25 percent.

Creation of first offshore mutual fund for debt-equity transactions is approved.

A $300 million stabilization fund created with copper price windfall.

1988

New tax measures introduced:

Additional corporate income tax cut from 40 to 35 percent
Licensing taxes reduced
Special tax on select electronics goods eliminated
A 4 percent tax on foreign interest payments introduced
Value-added tax cut from 20 to 16 percent.

Start of two-year phaseout of mandatory minimum-financing terms for imports.

External debt declines, to $19 billion. Debt-conversions account for $2.9 billion in debt- reduction in 1988 alone.

Chile reaches agreement with commercial bank creditors on interest rate reductions and plans for future debt buy-backs.

Average copper prices up by 54 percent over previous year.

Fiscal deficit reduced to 0.3 percent of GDP.

General Pinochet's bid for another eight years in office defeated in a national plebiscite.

1989

Import duties on small vehicles reduced from 40 percent to an overall level of 15 percent.

Daily currency devaluation rate slowed slightly to keep inflation in check.

Special debt-conversion facility set up to assist Chilean exporters hurt by the grape scare in the U.S.

Peso depreciation mechanism, based on strict inflation differential, reintroduced.

Central Bank made autonomous, with an independent board of directors.

Christian Democrat Patricio Aylwin, the candidate of a 13-party opposition group, wins Chile's first free election in almost 20 years.

1990

Patricio Aylwin is inaugurated President, pledging greater social consciousness but general continuity with existing economic policies.

Pharmaceutical patent protection law passed, in response to pressure from U.S. government and international drug manufacturers.

Labor code reform is proposed.

VAT rate hiked by two percentage points.

Monetary policy tightened to ease inflationary pressures.

III. Analysis of the Reforms

A. Timing

- **The transformation of the Chilean economy toward market-based policies began shortly after the military coup of 1973,** which took place in an atmosphere of hyperinflation, acute external instability, and sharp political polarization. Initially, the military intervention was welcomed by rightist and centrist political groups, especially the urban middle class.

- **Between 1979 and 1981, the government backtracked in some critical policy areas as the overall thrust of policy turned somewhat expansionary.** One widely criticized decision was the 1979 freezing of the exchange rate.

- **Chile's reform progress was severely affected both by the fall in international copper prices and the outbreak of the Latin American debt crisis in 1982.** A new stabilization effort had to be launched. Temporarily reversing a trend toward privatization of state-owned assets, the government rescued several major financial institutions which were failing. The country was forced to commit to new IMF agreements and renegotiate its external obligations.

- **The second wave of structural reform of the economy was undertaken in 1985, after basic external stability was assured.** Officials recognized that important structural changes were needed to ensure long-term stability and growth. This new reform phase coincided with a period in which the nation's terms of trade continued to be negative, due to low copper prices.

- **The restoration of growth after 1985 reinforced export-based policies and enabled officials to deepen the structural reform effort.** Foreign investment rules were further liberalized and a new privatization program was begun.

- **The recovery in copper prices after 1986 helped spur overall economic growth and strengthened government finances.** Consequently, officials were able to cut various tax and tariff rates in the 1987-89 period without jeopardizing fiscal stability.

- **The 1989 presidential campaign period was marked by a loosening in monetary and government spending controls, but the basic economic program was kept intact.** The government continued to pursue privatizations. Before leaving office, the outgoing Pinochet regime pushed through the law, making the Central Bank autonomous.

- **While privatization was initiated in the early part of the military period, the most important divestitures took place after 1985.** The privatization of various utility, telephone, and transportation interests between 1986 and 1989 amounted to some $3.5 billion.

B. Sequencing

- **The bank crisis that erupted in 1982 shaped generally conservative financial policies in the subsequent reform period.** Having just barely averted a collapse of the financial system, the government was understandably reluctant to commit to rapid deregulation. Authorities recognized the mistake of a too-rapid bank and financial market reform in the late 1970s. But this realization did not prevent them from cautious financial market liberalization later in the decade.

- **Effective fiscal reforms were institutionalized prior to 1980, obviating the need for massive spending cuts and tax increases in the 1985-89 period.** Chile got its fiscal house in order well before it was hit by the debt crisis. The emphasis of fiscal policy in the post-1984 reform period was therefore not deficit reduction, but rather encouraging savings and investment.

- **From the very beginning of reform in 1974, trade liberalization was a cornerstone of Chile's economic transformation.** The precipitous decline in nominal tariff rates — from 140 percent in 1974 to 60 percent in 1977 to 10 percent in 1979 — was unprecedented in Latin America. Despite the temporary policy correction (caused by the 1982 debt and financial crisis), Chile has maintained an extraordinarily open trading system.

- **Chile opened up to foreign investment early on.** Its 1977 Law 600 was a radical break with the generally restrictive policies in existence throughout Latin America.

Structural Reform Matrix (SRM)
Worksheet for Chile

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1984		Reform Period 1985-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	90%	8.1	90%	8.1
		Low and Uniform Tariff Barriers	6	80%	4.8	90%	5.4
		No Local Content Regulations	4	90%	3.6	90%	3.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	80%	7.2
		Minimal Exchange Controls	5	80%	4.0	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	90%	6.3	90%	6.3
		Minimal Preferential Interest Rates	1	90%	0.9	90%	0.9
		Equal Access to Capital	3	80%	2.4	90%	2.7
11	Prices and Wages	Limited Wage and Price Controls	7	50%	3.5	100%	7.0
		Minimal Subsidies	4	90%	3.6	90%	3.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	80%	4.8	90%	5.4
		Reduced Marginal Tax Rate	2	70%	1.4	90%	1.8
		Equitable / Uniform Tax Collection	2	90%	1.8	90%	1.8
10	Privatization	Divest Nonstrategic SOE's	5	70%	3.5	100%	5.0
		Franchise Out State Services	2	80%	1.6	80%	1.6
		Simulated Privatization	3	80%	2.4	90%	2.7
7	Foreign Investment	Non-Discriminatory Treatment	6	100%	6.0	100%	6.0
		Proactive Promotion	1	70%	0.7	90%	0.9
2	Information	Free Flow of Market Information	2	60%	1.2	90%	1.8
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2
		Efficient Gov. Administration	2	90%	1.6	90%	1.8
		Legal and Accounting System	2	70%	1.4	80%	1.6
		Infrastructure	3	70%	2.1	90%	2.7
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	77.0	74.9	89.1	89.1

CHILE

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	7.8	5.5	-14.1	-0.7	6.3	2.4	5.7	5.7	7.4	10.0
By sector: Agriculture	.8	3.8	-1.2	-2.5	7.5	5.6	8.8	3.2	4.4	--
Industrial Activity	8.2	6.3	-14.9	0.7	7.5	3.6	5.3	4.9	6.5	--
Services	8.1	5.3	-15.4	-1.3	5.4	1.1	5.3	6.8	8.5	--
Per Cap. GDP-Current US $	2100	2600	2220	1920	1690	1450	1340	1360	1510	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	37.45	37.55	29.41	27.37	27.33	25.74	29.25	31.75	31.89	25.41
Purchasing Index, US=100	86.95	89.58	72.43	57.58	53.39	41.67	70.64	80.77	85.67	72.88
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	6.19	6.30	4.32	3.41	4.12	3.65	3.22	3.74	4.11	--
Exports (fob) (1980 prices)	4.71	4.42	4.88	4.79	4.93	5.33	5.91	6.08	6.36	--
Current Account	-1.97	-4.73	-2.30	-1.12	-2.11	-1.33	-1.14	-0.81	-0.17	-0.91
Capital Account	3.22	4.80	0.95	-3.17	0.10	-1.28	-1.67	-1.12	--	--
Changes in Reserves	-1.40	-0.08	1.37	0.50	-0.20	0.17	0.53	-0.03	-0.80	-0.58
External Debt	12.08	15.66	17.31	17.93	19.74	20.38	21.14	21.50	19.65	--
Interest Payments (on foreign debt)	0.48	0.49	0.55	0.56	1.98	1.64	1.41	1.39	1.02	1.33
Export Growth %	8.3	-6.0	10.5	-2.0	3.0	8.0	11.0	2.8	4.6	--
Terms of Trade % Change	-9.0	-13.6	-7.7	7.7	-5.9	-1.8	-8.3	7.1	20.9	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

CHILE

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	35.1	19.7	9.9	27.3	19.9	30.7	19.5	19.9	14.7	--
Fiscal Deficit (-)/Surplus as a % of GDP	5.4	2.6	-1.0	-2.6	-3.0	-2.4	-1.0	0.5	-0.2	--
Investment Share of GDP %	21.0	22.7	11.3	9.8	13.6	13.7	14.6	16.9	17.0	--
Savings Share of GDP %	16.8	12.4	9.4	12.5	12.6	16.5	18.4	21.0	24.2	--
Unemployment %	10.4	11.3	19.6	14.6	13.9	12.2	--	--	--	--
Real Wage Index[1] 1980=100	100.0	121.0	124.0	112.0	105.0	97.0	107.0	--	--	--
Government Share in Economy %[2]	26.1	28.0	34.4	32.4	32.9	31.7	29.9	27.9	33.7	--
Gross New Foreign Investment (US mn$)	213.5	383.2	401.0	135.0	78.0	64.0	60.0	105.0	125.0	269.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

COLOMBIA

Prepared for the Center for International Private Enterprise

COLOMBIA

General Assessment of Reform

- **Since the 1970s, Colombia has embraced a conservative style of economic management which has yielded relatively high levels of economic stability and GDP growth.** The nation has carefully avoided the macro policy extremes that have made many of the other Latin American business operating environments extremely volatile and threatening to investors. At the same time, officials have failed to tackle key structural problems in the economy which limit growth, diversification, and real income increases.

- **Colombia's economic adjustment period (1983-85) was relatively swift.** This was its reward for avoiding excessive foreign borrowing in the late 1970s and for taking decisive action on fiscal and currency management policy before more severe problems set in.

- **However, Colombia has taken a more gradualist approach to microeconomic reform.** Up until Gaviria assumed the presidency, a rather slow, cautious approach to trade reform, deregulation, and privatization was observed. Major distortions, as a result, continue to hinder market forces in finance, banking, and trade sectors. Especially in trade and foreign investment reform, Colombia lags behind a number of other large Latin American nations.

- **The key destabilizing elements in Colombia are not economic in nature but political.** Political violence — the action of drug traffickers, left wing guerrillas and right wing death squads — has been endemic since the mid-1980s. To the government, this violence is a source of grave preoccupation and intimidation. It is also a hurdle to long-term political and economic modernization.

- **Both the real and indirect costs of political and drug-related violence have been extremely high.** In 1988, damage to oil pipelines inflicted by guerrillas cost the country nearly $500 million in lost revenue — about 10 percent of export earnings. Also, mandatory investments in military and counter-terrorism have strained fiscal resources. Finally, violence and security concerns have unquestionably cost Colombia new foreign

investment, which has been heavily concentrated in mining and petroleum during the 1980s.

- **Colombia has managed to achieve a high level of external stability without renegotiating its foreign debt.** It is the only major Latin American debtor nation to do this. Also, Colombia did not commit to a major IMF stabilization program in the 1980s, although it did accept IMF policy monitoring and World Bank structural reform support.

I. Background to Reform

The recession that the Colombian economy was faced with in the first part of the 1980s was moderate by Latin American standards. GDP per capita was kept at pre-recession levels, and the country's debt ratios did not represent a tremendous restraint on future growth and development. Three major and different external shocks contributed to Colombia's economic maladies from 1980 to 1983: The fall in coffee prices in mid-1980, and the outbreak of the Latin American debt crisis in 1982 (which effectively cut off private external funding, and Venezuela's 1983 stabilization program). The latter resulted in reduced exports, border sales, and receipts from tourism.

The Turbay administration (1978-82) advanced an economic program in the 1980-82 period. Turbay expanded public expenditure while curtailing monetary expansion and, at the same time, liberalized import controls. Public sector wages also rose rapidly. One result was a large and growing fiscal deficit. In 1984, the Betancur government (1982-86) began an adjustment program to correct the fiscal and current account deficits. The orthodox reforms in the 1984-85 period led to more far-reaching structural changes in policy with the Barco administration in 1986.

II. Evolution and Chronology of Colombia's Economic Reform

1980

Colombia is hit hard by sharp downturn in world coffee market:

Turbay administration fails to take effective action to stem deterioration in external accounts
Import liberalization goals move forward
Currency begins to grow seriously overvalued.

1981

External sector continues to deteriorate:

Current account turns negative
Current account deficits financed by large-scale external borrowing — $2 billion in both 1981 and 1982
Government tries to repel recession by increasing public spending and investment.

1982

Belisario Betancur of the Conservative party is elected president.

Peso overvaluation rises to 30 percent (relative to 1975 parity level).

Current account deficit rises to close to $3 billion.

Crisis erupts in the financial sector:

Government enacts tight ownership reforms and other new regulations to bolster sector.

Consolidated public sector deficit reaches 8 percent of GDP (up from 3 percent in 1980).

1983

Government takes new tack as recessionary conditions deepen and Colombia's supply of foreign exchange reserves dwindles:

Pace of crawling peg devaluation is accelerated
Export subsidies and import tariffs are hiked
Prior import deposits mandated for some transactions
Import licensing is expanded; some imports prohibited.

Tax reform measures are implemented and aimed at increasing income tax revenues:

Government strengthens its control systems, increases withholding, and broadens the base for presumption of income
Sales tax is transformed into a value-added tax: VAT is extended to industrial, wholesale, and retail sales, and some services
Regional and municipal taxes are reformed
CIF import tax is increased from 1.5 to 2 percent.

Large, promising, new oil fields are discovered.

1984

CIF import tax is increased to 8 percent.

A new minister of finance is installed and an orthodox adjustment strategy is adopted. Key planks include:

Reduction of public sector deficit and current account deficit
Promotion of exports and export-led growth
Regain access to international equity markets.

Betancur administration refuses to consider a standby agreement with the IMF, claiming that Colombia is not subject to economic mismanagement, it has good export prospects, and it will follow a self-disciplining strategy:

World Bank plays a crucial role as supplier of balance-of-payments credits and as mediator with the private banks
Banks demand IMF support for the adjustment program and government finally adopts IMF monitoring to avoid a standby agreement.

Additional fiscal reforms enacted:

Additional 8 percent tariff on all imports, except foodstuffs and agricultural inputs imported by the government
Several exemptions to the sales tax are eliminated
Savings in government bonds are forced proportional to the income tax.

1985

A structural adjustment program is introduced (informally monitored by the IMF):

Involves wide-ranging fiscal, monetary, and trade policy reforms.

Authorities slightly loosen restrictions on foreign participation in the banking sector by allowing foreign interests to take more than a 49 percent stake in a bank which is threatened with collapse.

IMF, World Bank, and local exporter, pressure forces authorities to allow the overvalued peso to slide by 51.2 percent in nominal terms during the year.

Steps are taken toward import liberalization:

Number of tariff categories that do not require a prior import license are increased (4,160 in 1984 to 3,602 in 1985, and eventually to 3,081 in 1987).

Tax reform measures advanced:

Earmarked revenues are partially redistributed within the government
Withholding mechanism for income tax is significantly extended
Some income tax exemptions are eliminated for Ecopetrol and Carbocol (state enterprises)
The declaration form for wage-earners is abolished.

1986

Liberal party wins majority in congressional elections.

Liberal party candidate, Virgilio Barco Vargas, is elected president.

Fiscal policy includes measures to ensure that state companies re-direct surplus funds to others with debt repayment problems.

CIF import tax is raised to 18 percent.

Tax reforms are approved at the end of the year with the principal aim of the package being to promote savings, investment, and better business practices in the private sector; the main aspects of the reform are:

Unification of corporate taxes at 30 percent, to be achieved over three years
Elimination of double taxation
Gradual reduction of tax deductions for increases in interest rates and other inflation-related costs
Raising of the personal income tax threshold with a simultaneous ending of many deductions and a lowering of the maximum marginal tax rate
Amnesty for tax evaders.

1987

Government begins to reduce import controls.

Foreign investment requirements are liberalized in line with more lenient Andean Common Market regulations:

Period during which foreign companies are required to become national-mixed companies is extended from 15 to 30 years
49 percent ceiling on foreign capital may be eliminated in some sectors
Foreign investors are allowed to purchase stocks in national-mixed companies, other than those that are going bankrupt.

Authorities increase reserve requirements to control money supply:

As of November, banks were required to stop lending until the end of the year.

1988

A new $1 billion loan from commercial banks is signed in January.

Colombian authorities implement a major tariff reform, with plans for completion by mid-1988:

A reduction in overall tariff levels and a more rational system for local industry and job protection are included.

Government cuts the tax on profits and dividends paid by foreign companies from 30 percent to 25 percent:

Dividends reinvested in Colombia are tax exempt.

Liquidity crisis forces the government to relax its reserve requirement rulings from 1987.

Central Bank places a ceiling on interest rates, which had risen to 50 percent p.a. (vs. 24-25 percent inflation).

Priority is given to the approval of imports of capital goods and raw materials for use in the manufacturing and agricultural sectors.

1989

A commission is established to prepare for privatization in the banking sector:

Government plans to return previously "intervened" banks to private ownership.

Government lifts ceilings on interest rates on loans and savings accounts:

Ceiling is raised for term certificates of deposit.

Government further reduces foreign companies taxes on profits and dividends by five percentage points a year:

Full phase-out slated for 1993.

A $1.65 billion loan package is signed with private foreign bank creditors.

An "economic opening" policy package is proposed and scheduled to begin in August, but is put on hold for political reasons:

Involved further liberalization of the import licensing regime and the foreign exchange budget.

Senator Luis Carlos Galan, country's most popular political leader and presidential hopeful, is assassinated by the drug mafia, outraging the country:

Government launches an all-out offensive against drug traffickers.

Future joint-venture contracts with foreign oil companies are approved for Ecopetrol, the state oil company.

Measures are announced to control the budget deficit:

Investment plans are curtailed
Wage increases are kept below inflation
Devaluation is accelerated
Gas prices are increased by 25 percent.

1990

Cesar Gaviria Trujillo, candidate of the Partido Liberal (PL), is elected president on May 27.

First phase of a five-year trade liberalization program begins:

- 861 products are removed from the list requiring prior import licenses
- Prior licensing restrictions on imports of 750 domestically produced products are lifted provisionally for two years; a ceiling of $150 million is maintained and quotas are to be allocated through a bidding system.

Bilateral trade agreement with the United States is signed.

Creditor banks approve new $1.8 billion credit to refinance the country's foreign debt for 1991-94.

In November, government suspends purchase of dollars until the second quarter of 1991.

Major labor action against privatization succeeds in shutting down industrial sector for one day in November.

Government puts a total of 45 firms on the auction block:

- Sectors include mining, metals, telecommunications, tourism, processed foods,and banking
- Foreign banks withdraw bid for one state-held bank, pending outcome of a lawsuit by the bank's former owners to regain control
- Several significant privatizations are realized during the year.

In December, Congress approves major reform package, which accelerates President Cesar Gaviria's economic modernization campaign:

- Foreign Trade Ministry created to manage all trade related affairs
- Government sets a goal of average 15 percent tariff rates by 1994, down from 35 percent current rate.

Goals also include reduction of number of tariff levels from 10 to 4.

Value-added tax raised two points, to 12 percent.

Foreign exchange regulations revamped:

Colombian citizens allowed to hold foreign currency, as well as overseas bank accounts
Central Bank's monopoly on trading in foreign exchange, gold, and platinum is ended
Elimination of requirement that all foreign exchange be sold to the Central Bank.

Banking sector further liberalized:

Expansion into select non-banking activities allowed
Elimination of restrictions on foreign investment in financial institutions; 100 percent foreign ownership now permitted.

III. Analysis of the Reforms

A. Timing

- **In 1984, Colombia was forced to take fairly strong adjustment measures to address large deficits in its fiscal and balance-of-payments accounts.** These problems resulted from overly expansive policies in the 1980-83 period, when officials battled a deep recession and overlooked growing imbalances in the external accounts. The recession, in turn, resulted in large part from a downturn in export earnings, particularly coffee. By 1984, Colombia had to confront its current account deficit in the interest of preserving its foreign exchange reserves. One objective of the adjustment policies that followed was to increase the competitiveness of non-coffee exports.

- **The decisive switch from expansionary to adjustment policies took place at around the mid-term point of Betancur's presidency.** The change in direction was marked by the appointment of a new, conservatively oriented, finance minister.

- **Under the Liberal party government of Virgilio Barco (1986-90), the economic policy emphasis turned to structural reform issues.** Barco's team benefited from a sharp rise in export earnings, starting in 1986, which kept the economy on a secure footing. Also, by that time, the Colombian economy was starting to realize healthy growth. These favorable conditions made the political task of "selling" the reform less onerous for the administration than it would have been in a more adverse

environment. Also, as Barco started his term, he enjoyed the advantage of a solid congressional majority in his term.

- **President Cesar Gaviria has several important elements in his favor as he attempts to deepen the economic modernization process.** He is youthful, popular, and his appeals have been well received among a population yearning for democratic and institutional reform. His cabinet appointments have been roundly applauded as including an important cross-section of opinions and political backgrounds. One of his ministers, in fact, is a former leader of the M-19 guerrilla group and is now a leader of the political group by the same name.

B. Sequencing

- **Early in the adjustment process, Colombia prioritized fiscal reform.** According to one revealing fiscal measure (the overall balance of the consolidated nonfinancial public sector), the deficit fell from 4.3 percent of GDP in 1984 to around 1.6 percent in 1986. In subsequent years, the deficit stayed close to 1-2 percent of GDP. Initial gains on the fiscal side were the result of revenue enhancement, rather than expenditure reduction. After 1986, however, officials had to curtail growth in expenditures. On a per capita basis at least, there is evidence of a decline in per capita spending on social programs as early as 1985.

- **Devaluation of the peso to benefit the export sectors was also a central policy priority.** The real effective exchange rate fell by 30 percent during 1985. Since then, officials have used a crawling-peg-mechanism to keep the currency competitive. The peg has helped engender stability and market confidence as well.

- **Promotion of import liberalization, foreign investment reform, deregulation, and privatization are relatively recent developments.** The government has moved cautiously on these fronts, in part as a result of resistance from entrenched interests— labor, bureaucrats, and private companies as well. Yet, a more aggressive approach to these goals is now evident under the Gaviria administration.

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Structural Reform Matrix (SRM)
Worksheet for Colombia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1984		Reform Period 1985-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	40%	3.6	50%	4.5
		Low and Uniform Tariff Barriers	6	40%	2.4	60%	3.6
		No Local Content Regulations	4	50%	2.0	60%	2.4
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	60%	5.4	80%	7.2
		Minimal Exchange Controls	5	40%	2.0	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	60%	4.2	70%	4.9
		Minimal Preferential Interest Rates	1	40%	0.4	50%	0.5
		Equal Access to Capital	3	30%	0.9	40%	1.2
11	Prices and Wages	Limited Wage and Price Controls	7	80%	5.6	90%	6.3
		Minimal Subsidies	4	50%	2.0	50%	2.0
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	60%	3.6	90%	5.4
		Reduced Marginal Tax Rate	2	50%	1.0	60%	1.2
		Equitable / Uniform Tax Collection	2	70%	1.4	90%	1.8
10	Privatization	Divest Nonstrategic SOE's	5	40%	2.0	60%	3.0
		Franchise Out State Services	2	50%	1.0	50%	1.0
		Simulated Privatization	3	30%	0.9	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	60%	3.6
		Proactive Promotion	1	50%	0.5	80%	0.8
2	Information	Free Flow of Market Information	2	70%	1.4	70%	1.4
16	Enabling Environment	Private Property Rights	9	60%	5.4	60%	5.4
		Efficient Gov. Administration	2	60%	1.2	60%	1.2
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	80%	2.4	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	53.5	53.7	65.2	66.0

COLOMBIA

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	4.1	2.3	0.9	1.6	3.4	3.1	5.8	5.5	3.5	3.2
By sector: Agriculture	2.2	3.2	-1.9	2.8	1.8	1.6	3.4	6.0	3.0	--
Industrial Activity	3.6	-0.9	-0.4	3.4	6.9	6.0	11.1	6.4	2.4	--
Services	5.3	3.7	3.0	0.1	2.2	2.1	3.8	4.3	4.9	--
Per Cap. GDP-US$ (1985)	1220	1370	1440	1440	1430	1350	1280	1240	1240	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	22.38	21.78	22.42	21.28	20.88	20.06	20.96	22.19	21.54	22.28
Purchasing Index, US=100	50.88	50.79	49.69	46.68	42.81	36.03	47.99	48.50	48.84	49.42
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	4.66	5.15	5.65	5.23	4.82	4.50	3.90	3.93	4.28	--
Exports (fob) (1980 prices)	3.95	3.46	3.34	3.43	3.77	3.94	5.18	6.50	6.23	--
Current Account	-0.21	-1.96	-3.05	-3.00	-1.40	-1.81	0.38	0.34	-0.20	0.04
Capital Account	1.12	1.90	2.20	1.16	1.02	1.96	0.91	0.06	--	--
Changes in Reserves	-1.24	-0.22	0.72	1.75	1.17	-0.29	-1.35	0.11	-0.35	-0.26
External Debt	6.94	8.72	10.31	11.41	12.04	14.24	15.36	17.01	17.00	--
Interest Payments (on foreign debt)	0.31	0.41	0.71	0.63	0.62	0.87	0.98	1.18	1.21	1.38
Export Growth %	18.1	-12.5	-3.5	2.8	10.0	4.4	31.6	25.4	-4.0	--
Terms of Trade % Change	-11.7	-9.5	6.5	-2.0	4.8	-0.8	1.6	-29.6	-0.4	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

COLOMBIA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	26.5	27.5	24.5	19.8	16.1	24.0	18.9	23.3	28.1	25.8
Fiscal Deficit (-)/Surplus as a % of GDP	-1.8	-3.1	-4.7	-4.2	-4.3	-3.2	-1.6	-0.7	--	--
Investment Share of GDP %	19.1	20.6	20.5	19.9	19.0	19.0	18.0	19.5	20.6	--
Savings Share of GDP %	19.7	17.1	16.2	17.1	18.4	20.3	24.8	23.8	22.3	--
Unemployment %	9.1	8.1	9.2	11.2	13.0	12.9	12.3	10.2	10.3	--
Real Wage Index[1] 1980=100	100.0	101.0	104.0	108.0	117.0	116.0	154.0	--	--	--
Government Share in Economy %[2]	10.5	11.1	12.3	12.7	13.5	11.8	11.2	11.9	--	--
Gross New Investment (US mn$)	157.5	265.3	366.0	618.0	584.0	1023.0	674.0	319.0	203.0	576.0

[1] Refers to manufacturing wages only.
[2] Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

COSTA RICA

COSTA RICA

General Assessment of Reform

- **Costa Rica's structural economic reform efforts have been moderately vigorous and appear to have achieved a high measure of success.** The economy has secured stability, growth, and economic diversification.

- **Political stability has greatly helped the effort, particularly with respect to foreign investment.** Costa Rica, with its strong, civilian-led democratic institutions, stood out in contrast to its Central American neighbors. Perhaps more than any other nation in the region, Costa Rica was able to capitalize on the U.S. government's strong support for private investment in the Caribbean during the 1980s.

- **Costa Rica's ability to sustain economic reform was enhanced by the results of policy reform to date.** Among other indicators, real GDP growth expanded by an average annual rate of 4 percent between 1986 and 1990. On a per capita basis, this translates into real annual growth of 1.7 percent. This compares favorably with the Central American regional average of a 0.5 percent decline in per capita GDP over the same period.

- **Since 1983, support from the IMF and World Bank has been significant.** Fund credits have helped stabilize the balance-of-payments situation, while World Bank structural adjustment funding has encouraged the economic liberalization process.

- **Economic diversification appears to have been both a key cause and effect of Costa Rica's reform efforts.** The right economic policies combined with effective foreign investment promotion have resulted in substantial increases in foreign investment, much of which has been in non-traditional areas. Exports of non-traditional manufactures have grown rapidly since the mid-1980s as a result, thereby strengthening the nation's balance-of-payments situation.

- **Reducing foreign debt-servicing and repayment appears to have been critical for Costa Rica's stabilization and reform efforts.** The nation would not likely have achieved external economic stability had it attempted to fully service its foreign debt. Debt-relief under the so-called "Brady Plan" essentially

sanctioned earlier decisions on the debt already taken by the government.

- **Political continuity has helped sustain the reform drive.** The 1986 election victory of PLN candidate Oscar Arias Sanchez meant a general continuation of the reform policies begun by his PLN predecessor. What remains to be seen is the extent to which the new government of Rafael Angel Calderon of the PUSC will stay the course of the reform effort. Calderon was elected in 1990 (by a narrow margin) on a campaign platform promising to soften the social impact of economic reform.

- **Policy flexibility may have helped sustain economic liberalization as well.** President Arias, for example, softened austere agricultural price and subsidy policies when faced with sharp domestic opposition in 1986. It is also notable that in response to labor and other domestic pressure groups, Costa Rica has maintained price controls on basic goods. This flexibility has not been without a fiscal cost, but this cost appears not to have been unreasonable. Without such "safety nets," officials may not have managed to build and maintain a domestic political consensus around reform.

- **Costa Rica's political neutrality in the Central American conflict and domestic political stability were favorable elements in its fiscal campaign.** Unlike its other Central American neighbors, Costa Rica did not undertake massive military expenditures, and its leadership was not distracted by the civil wars and political instability that swept the region in the 1980s.

I. Background to Reform

After two decades of rapid development, based primarily on agricultural exports and expansion of industrial production, Costa Rica's economy underwent serious decline. The 1980-81 oil price shock precipitated a major economic downturn, which caused GDP growth to tumble by 7.3 percent in 1982, with inflation rising to 90 percent.

Costa Rica enacted stabilization measures in mid-1982 to restore external equilibrium and to contain inflationary measures. In 1983, the nation secured foreign debt-rescheduling agreements with its foreign bank creditors. As improvements in the economic and financial situation emerged, Costa Rica began incremental

reforms in 1984 including a competitive exchange rate policy and foreign trade liberalization.

II. Evolution and Chronology of Costa Rica's Economic Reform

1981

Export Processing Zones Law.

Established publicly and privately operated free zone industrial parks throughout Costa Rica.

Provided benefits for exporters including total exemption from import duties on inputs, export taxes, sales and consumer taxes, taxes levied on remittances abroad, and taxes on profits for a specified period.

World oil price hike presents major shock to Costa Rican economy.

In August, Costa Rica suspends debt-service to all but multilateral creditors.

1982

Economic crisis worsens as GDP falls by 7.3 percent and inflation climbs to 90 percent.

Luis Alberto Monge: Conservative Partido de Liberacion Nacional (PLN) wins presidential elections.

Government introduces adjustment measures in mid-year to restore external equilibrium.

Far-reaching amendments to the Central Bank's basic laws are announced:

All foreign exchange transactions are centralized through the Central Bank and the national banking system
A two-rate exchange rate system is established.

1983

New government signs a 12-month standby arrangement with the IMF of $100 million. In conjunction with this arrangement a stabilization program is adopted. Objectives include the following:

Control the erratic fluctuations of the exchange rate

Stabilize the economy and reduce inflationary pressures
Reestablish the overall equilibrium of the balance of payments
Reestablish the country's foreign credit with international financial institutions.

The Costa Rican Coalition for Development Initiatives (CINDE) is formed to actively promote foreign investment.

CINDE is a non-profit private association with offices in the U.S.

1984

U.S. Caribbean Basin Initiative (CBI) goes into effect:

Provides duty-free access to the U.S. market for 12 years for virtually all products wherein Costa Rica is a beneficiary nation.

Revised IMF agreement is completed in March; it is accompanied by an Economic Emergency Law passed by the Costa Rican Congress:

Calls for substantial cuts in consumer and producer subsidies
Export taxes on banana shipments cut by one-fourth.

Key members of the government's economic team resign, forcing a major reorganization.

Financial Stabilization Act:

Creates the export contract; an agreement between the government and a private sector producer to expand production of non-traditional export products for sale outside the CACM in exchange for certain government benefits:

Total income tax deductions on profits from non-traditional exports to third countries
Reduced port charges
Simplification of procedures
Bank financing at preferential rates
Tax reductions
Accelerated depreciation
50 percent tax credit on stock purchases of entirely exporting firms

Duty-free import of inputs for production of non-traditional products to be exported to third countries
Duty-free temporary entry for inputs used in assembly operations, samples, and other inputs.

Government announces an exchange rate policy of regular mini-devaluations (about twice a month):

System is designed to compensate for the differential between local WPI increases and those in a trade-weighted basket of foreign currencies.

Central Bank raises deposit requirement for foreign exchange purchases to 100 percent for imports and debt payments.

Costa Rica restricts trade with Nicaragua to a volume matched by imports.

1985

A major debt-rescheduling is completed with the commercial banks.

Government extends restriction on trade to a volume matched by imports to all Central American Common Market (CACM) countries.

A new incentives law for tourism is approved:

Income tax exemptions are granted as are other levies in areas of tourism: air transport, car rentals, travel agencies, hotels and restaurants
Imports for tourism are exempt from import duties
The EC grants Costa Rica "most favored nation" status.

1986

Ad valorem tariffs are set by the uniform CACM agreement on customs and tariffs as of January.

Elections are held and the PLN retains power under the leadership of Oscar Arias Sanchez:

Only the second time in Costa Rican history that a ruling party has successfully been re-elected.

Major privatization program is begun. More than 30 companies worth $130 million are sold throughout next three years.

In response to domestic political pressures, President Arias modifies market-based reforms in agricultural sector.

A short-lived debt-swap mechanism scheme is instituted:

Before suspension of the program in December, 73 investment proposals worth $280 million are submitted; 32 projects worth $78.5 million are approved and finalized
The program allows Costa Rica to reduce its foreign debt by $123.2 million.

Government aggressively encourages foreign investment:

A Ministry of Foreign Trade and several top-level agencies are established
Generous tax incentives are available for export and tourism industries
A lowering of corporate income taxes is planned.

1987

Central Bank President Eduardo Lizano submits his resignation, citing difficulties in achieving economic stability with the country's heavy debt burden:

A debate surrounding a cut in agricultural subsidies, supported by Lizano but rejected by the opposition, was a major issue.

IMF endorses a letter of intent for a $55 million standby agreement with the following goals:

A reduction in the public sector deficit from 5.8 percent of GDP in 1986 to 3 percent by 1988; public hiring freeze and a cut in worker benefits included
An increase in public utility and transport rates
State holding company CODESA divests publicly held companies
Restrictive monetary policy lowering inflation to 10 percent in 1987 and 7 percent in 1988
Flexible interest rate policy for state banks continued
Further reductions in import tariffs
New incentives for exporters are enacted.

Severe liquidity control measures are undertaken in October:

Legal reserve requirement for the banking system is increased to 35 percent

The amount importers must deposit with banks before obtaining foreign exchange is increased.

Tax reform package is approved in November:

Direct and indirect taxation is increased; tax revenues will increase by 3/4 of 1 percent of GDP on a yearly basis
Goods subject to new or higher taxes include expensive homes, automobiles and securities
A 10 percent tax is announced on public entertainment, casino gambling and charges for advertisements in the local media.

1988

Costa Rican authorities devalue the currency by 5.7 percent in mid-January in an attempt to restore competitiveness.

Financial crisis in February leads authorities to relax monetary policy; inflation spirals to 25.4 percent by end of year.

Bill is passed by Congress which extends most of the rights enjoyed by the nationalized banking sector to private institutions.

1989

Increase in prices in 1988 necessitates tough deflationary measures:

Credit controls
Price controls
Fixed public sector tariffs
Slowdown in exchange rate devaluation.

IMF approves a one-year standby program.

A second World Bank structural adjustment loan is agreed to in September; total is $200 million, half from the World Bank and half from the Japanese government.

10 percent export tax on coffee is abolished; government revenues fall.

Judicial decision gives state employees wage settlements above government guidelines; public sector wage bill increases.

Costa Rica concludes an agreement on the rescheduling of its bilateral debt.

More privatization efforts are underway; a shrimp farm and cement plant are slated for privatization (the government will also liquidate seven small assets).

1990

The Partido Unidad Social Cristiano (PUSC), under the leadership of Rafael Angel Calderon, ousts the PLN in the February 4 election.

IMF withholds disbursements of Costa Rica's standby loan agreed in May 1989:

IMF expresses concern over fiscal deficit which was way above the Fund's target.

New government announces a 15 percent increase in the prices of fuel, electricity, telephones and drinking water.

An accord is reached, under the auspices of the Brady Plan, to reschedule the country's debt with commercial banks.

Mexico offers Costa Rica $65 million in trade credits.

An agreement with Japan has been signed to promote trade between the two countries.

Costa Rica becomes the 100th member of GATT on October 25:

Country agrees to maintain a maximum import tariff of 60 percent; a reduction to 55 percent is planned in three years
All import surcharges (except automobiles) will be eliminated
Import licenses and quotas will be removed.

New, expanded free zone law is passed in December to promote economic diversification.

III. Analysis of the Reforms

A. Timing

- **A severe foreign debt crisis that struck in the early 1980s forced Costa Rica to embark on an economic stabilization.** Starting in 1984, the stabilization effort evolved into a broader structural reform/economic liberalization effort, which has largely been sustained up to the present.

- **The initial stabilization effort was undertaken by the new presidential administration of Luis Alberto Monge.** The overriding goal of the short-term effort was stanching the outflow of foreign exchange reserves. To this end, Costa Rica suspended private foreign debt-servicing in 1982, and in 1983 arranged a standby agreement with the IMF.

- **Costa Rica's most intensive reform efforts seem to coincide with IMF performance reviews.** Likewise, economic policy, particularly government spending, has tended to veer from the reform course prior to presidential elections.

- **Costa Rica was well positioned to benefit from the U.S. Caribbean Basin Initiative.** When the CBI was launched in 1984, Costa Rica stood out as a model Central American democracy, with a relatively literate and skilled population.

B. Sequencing

- **Costa Rica's economic reform process followed the logical pattern of stabilization first, liberalization second. Significantly, however, economic reform and liberalization became a central feature of the government's longer-term stabilization efforts.** In response to its foreign debt crisis and deteriorating terms of trade, the government's initial priorities centered on restoring external equilibrium and gaining control of government spending. On both counts, policy efforts were largely successful.

- **Once basic stability was achieved, Costa Rica moved swiftly to liberalization and structural reform.** By 1984, the government was solidly committed to developing non-traditional sectors of the economy and encouraging foreign direct investment. On the latter count, Costa Rica early on embarked on an ambitious campaign to attract multi-national capital, particularly in

electronics and relatively high technology sectors, but without ignoring its comparative advantages in agriculture.

- **Throughout the reform period, the government continued to struggle with fiscal pressures and inflation.** Simultaneous pressures to cut taxes and maintain subsidies created enormous and recurring fiscal strains, which forced the government in 1987 to retighten fiscal and monetary policies. Later, in 1989, rising price pressures again forced officials to rein spending. In 1990, IMF withholding of loan disbursements forced another round of spending cuts and official price increases.

- **Costa Rica embraced trade liberalization later rather than earlier in its reform period.** Costa Rica's 1990 accession to the GATT represents an important institutional commitment to more liberal trade. Up to then, the nation operated under the relatively protectionist Central American Common Market trade system. Besides higher tariffs, third country (i.e., noncommon market) exporters to Costa Rica were at a disadvantage because of heavy nontariff surcharges.

Structural Reform Matrix (S...)
Worksheet for Costa Rica

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		Low and Uniform Tariff Barriers	6	50%	3.0	70%	4.2
		No Local Content Regulations	4	80%	3.2	80%	3.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	80%	7.2
		Minimal Exchange Controls	5	50%	2.5	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	70%	4.9	80%	5.6
		Minimal Preferential Interest Rates	1	70%	0.7	70%	0.7
		Equal Access to Capital	3	80%	2.4	80%	2.4
11	Prices and Wages	Limited Wage and Price Controls	7	60%	4.2	70%	4.9
		Minimal Subsidies	4	70%	2.8	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	80%	4.8
		Reduced Marginal Tax Rate	2	50%	1.0	90%	1.8
		Equitable / Uniform Tax Collection	2	50%	1.0	90%	1.8
10	Privatization	Divest Nonstrategic SOE's	5	30%	1.5	80%	4.0
		Franchise Out State Services	2	30%	0.6	60%	1.2
		Simulated Privatization	3	30%	0.9	60%	1.8
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	60%	3.6
		Proactive Promotion	1	70%	0.7	90%	0.9
2	Information	Free Flow of Market Information	2	60%	1.2	90%	1.8
16	Enabling Environment	Private Property Rights	9	50%	4.5	50%	4.5
		Efficient Gov. Administration	2	60%	1.2	60%	1.2
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	50%	1.5	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	54.8	52.4	73.5	71.2

COSTA RICA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	0.8	-2.3	-7.3	2.9	8.0	0.7	5.5	4.8	3.4	5.7
By sector: Agriculture	-0.5	5.1	-4.7	4.0	10.0	-5.5	4.3	4.6	5.5	--
Industrial Activity	1.2	-4.2	-13.5	4.1	11.3	1.5	6.4	5.0	2.1	--
Services	1.0	-3.7	-4.6	1.8	5.4	2.8	5.3	6.2	2.5	--
Per Cap. GDP-Current US $	1950	1530	1140	1060	1250	1400	1550	1660	1690	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	26.57	23.43	21.25	20.16	21.60	20.81	21.54	21.38	19.06	17.53
Purchasing Index, US=100	74.58	37.32	36.80	45.94	43.09	44.19	44.83	47.95	24.09	23.98
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	1.60	1.26	0.97	1.05	1.17	1.19	1.18	1.28	1.33	--
Exports (fob) (1980 prices)	1.03	1.08	0.97	0.95	1.10	1.11	1.12	1.26	1.27	--
Current Account	-0.66	-0.41	-0.27	-0.31	-0.25	-0.29	-0.16	-0.38	-0.30	-0.45
Capital Account	0.17	0.04	-0.08	-0.05	-0.18	-0.09	-0.21	-0.31	--	--
Changes in Reserves	-0.10	0.07	-0.14	-0.06	0.06	-0.05	-0.08	-0.01	--	--
External Debt	2.74	3.29	3.63	4.16	3.97	4.37	4.53	4.69	4.53	--
Interest Payments (on foreign debt)	0.13	0.11	0.08	0.50	0.24	0.34	0.22	0.15	0.19	0.25
Export Growth %	4.8	4.6	-9.7	-2.3	15.0	1.5	0.5	13.1	0.5	--
Terms of Trade % Change	-9.5	-7.4	0.2	3.4	-1.5	0.3	9.6	-17.9	15.0	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

COSTA RICA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	18.1	37.1	90.1	32.6	12.0	15.1	11.8	16.8	20.8	--
Fiscal Deficit (-)/Surplus as a % of GDP	-7.4	-2.9	-0.9	-2.1	-0.7	-1.3	-4.5	--	--	--
Investment Share of GDP %	26.6	29.0	24.7	24.2	22.7	25.4	23.7	28.3	26.0	--
Savings Share of GDP %	16.2	24.1	27.6	23.4	23.1	23.6	25.3	25.5	26.3	--
Unemployment %	5.9	8.7	9.4	9.0	5.0	6.8	--	--	--	--
Real Wage Index[1] 1980=100	--	--	--	--	--	--	--	--	--	--
Government Share in Economy %[2]	22.3	21.0	21.5	23.4	22.2	20.1	20.1	23.1	--	--
Gross New Foreign Investment (US mn$)	52.6	69.6	28.9	60.7	55.9	69.9	61.0	80.3	122.3	116.4

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

JAMAICA

Jamaica

General Assessment of Reform

- **Jamaica's structural economic reform efforts since 1980 have been ambitious, but not radical.** Edward Seaga's goals were to achieve macroeconomic adjustment and progressive microeconomic liberalization. Seaga believed in free-market principles, but he was also pragmatic and highly sensitive to political constraints to drastic reform. On a few occasions, his policies called for more, not less, state intervention, to correct perceived instances of "market failure." In sum, Seaga opted for progressive reform, not radical change.

- **The economic results of the policies followed by Edward Seaga and the (second) Michael Manley government have been on balance favorable.** However modest, Jamaica experienced positive real GDP growth for most of the 1980s decade. It has kept inflation under control and real per capita income has begun to recover, albeit slowly.

- **Probably the single most serious deficiency of the reform effort has been in the fiscal area.** Jamaica's track record for the 1980s reflects large and chronic fiscal deficits. The government has failed to gain control over public spending. Among the most commonly cited factors is overly- generous public sector wage increases.

- **The lack of dynamic growth in agriculture is considered to be one of the greatest disappointments of the Seaga reform program.** Fairly vigorous farm growth was recorded in the 1983-84 period, but results have been variable and generally not sustained. Particularly disappointing has been the failure of the non-traditional export sector, which has been widely assessed as having tremendous potential for growth.

- **Jamaica's privatization and divestments efforts have been impressive, if somewhat less successful than hoped.** Dozens of companies were privatized during the 1980s, representing assets valued at $160 million (not included are land, factories and other buildings). Many money-losing companies that could not be privatized were shut down by the Seaga government. Particularly in the tourism sector, many viable companies that the state could not (or in some cases would not) sell were turned over to private management. Finally, in

many instances, the government imposed private-sector-type efficiency standards on state companies, while increasing monitoring. The results of these measures on the bottom lines of Jamaican state companies have been significant.

- **The importance of U.S. support for the Seaga government's reform efforts cannot be overstated.** Edward Seaga was U.S. President Ronald Reagan's first visiting head of state. Seaga represented, to the Reagan White House, a hopeful new trend of conservative, democratic and pro-U.S. leadership in the Caribbean. Related to this, the Reagan administration viewed the Seaga program as an important experiment in market-based economic reform. The U.S. invested heavily in the Seaga program, and Jamaica clearly benefited from both the financial and moral support.

- **U.S. backing, combined with a switch to more pro-business policies, did not, however, lead to an upsurge in multinational corporate investment in Jamaica.** New trade incentives like the Caribbean Basin Initiative did not spark a groundswell of foreign investment in Jamaica — nor in any other Caribbean country for that matter. Jamaica and countries like the Dominican Republic did benefit from small-scale investments in light manufacturing and assembly industries. But lacking backward and forward linkages to the greater economy, these investments had limited developmental benefits. They were, however, important sources of low-skilled employment.

- **Foreign debt-management will remain a formidable challenge for Jamaica.** The island's external liabilities, while more favorably structured today, still weigh heavily on Jamaica. This foreign debt is now the equivalent of about one-and-one-half times the island's GDP. The repayment burden puts limits on the amount of resources available for domestic borrowing. Also, it puts a sizeable claim on the government's scarce foreign exchange resources.

- **The political moderation of Michael Manley has meant important continuity in policy.** Manley did not, as many feared, attempt to reverse the previous government's policies. In some respects, it has furthered them. The PNP government is now in a favorable position to improve upon the Seaga reforms. However, Manley and the PNP are not immune to political and trade union pressure to ease austerity policies. Also, as the Jamaican economy continues to open up, Manley will also have to manage opposition from local manufacturers.

I. Background to Reform

Edward Seaga and the Jamaica Labour Party won a sweeping victory in Jamaica's 1980 national election and promised to rebuild an economy that had undergone a precipitous decline under the Peoples' National Party government of Michael Manley (1972-80). Manley promoted economic nationalism and independence even as the Jamaican economy grew acutely in need of multilateral support. Manley alienated the business community, local and foreign, both in his nationalistic rhetoric and in his actual policies. An upsurge in capital flight further destabilized and weakened the economy that Edward Seaga inherited in 1980.

Jamaica's economic adjustment and structural reform era began with Edward Seaga. It continued under the new Michael Manley government, which was elected into office in 1989, on a surprisingly free-market economic platform stressing policy continuity.

II. Evolution and Chronology of Jamaica's Economic Reform

1974

Jamaica is hard hit by world oil price shock; island's import bill rises by more than 40 percent.

Michael Manley, Jamaica's socialist prime minister, announces plans to nationalize the property, mining operations, and refineries owned by the island's six North American-based aluminum companies:

Over next five years, government negotiates purchases of all land and majority shares in mining operations
Companies retain nearly total control of lucrative refining operations and long-term supply guarantees
Companies also retain managerial control.

Jamaican government raises bauxite levy some 600 percent:

Massive additional revenue allows government to take controlling interests in a wide range of private companies
Private monopolies, in particular, are targeted
Social programs are expanded as well
State trading companies are established, with trade union backing, to handle bulk trading of basic commodities and counter-trade.

Government's nationalist rhetoric increases.

1975

Business confidence in the Manley government turns sharply negative:

Investment levels fall
Capital flight starts to pick up.

1976

Fiscal deficit reaches 24 percent of GDP.

Foreign exchange reserves are exhausted:

Wide range of exchange controls are enacted.

Foreign commercial bank lending to Jamaica ceases.

Jamaica begins receiving balance-of-payments support from the IMF:

Pledges monetary and fiscal restraint
New tax package is introduced.

Government misses revenue targets; prints money to cover shortfall.

Manley's Peoples' National Party (PNP) retains government following national elections.

1977

IMF starts pressing Jamaica for more stringent adjustment measures:

A major devaluation
Cuts in spending and a balanced budget.

Manley advances alternative program:

New consumption taxes
Import restrictions
Rescue of bankrupt hotels and manufacturing enterprises
Refuses to devalue the currency.

New $75 million accord with the IMF is worked out:

Government promises improved fiscal management and monetary control
IMF allows creation of a dual exchange rate, in place of a straight devaluation.

Unions put immense pressure on government for major hike in wages.

Jamaica fails year-end IMF performance test:

Agrees to a series of mini-devaluations
Fund resumes program
Fails to win commercial bank interest in debt-renegotiation.

1978

Government publishes an investment code to spur new direct foreign investment but domestic and foreign investors alike are scared by radical tenor of PNP political rhetoric.

1979

Jamaica again fails IMF performance test:

Government refuses full range of stabilization measures required by the fund
Agreement is terminated.

1980

Manley government promotes "alternative" stabilization and recovery plan:

Results are dismal
Government is broke
Public enterprise losses soar to $65 million.

Political violence escalates as national elections are announced.

Jamaica Labour Party (JLP) leader Edward Seaga becomes prime minister with landslide JLP victory:

JLP secures solid parliamentary majority.

PNP leaves office with dubious economic record of seven consecutive years of negative GDP growth.

Seaga launches ambitious economic stabilization and recovery program. Key goals include:

Privatization or liquidation of loss-producing state companies, particularly hotels
Rollback of exchange controls and import duties
Greater enforcement of tax laws
Seaga resists devaluation.

1981

Seaga government commits to a new $650 million extended fund agreement with the IMF.

Government offers generous incentives to privatize hotels:

Six of 14 properties turned over to private management within first year
After this, hotel privatization effort slows down.

1982

A free parallel exchange market is opened up:

Jamaican currency nose-dives by 55 percent.

Seaga government buys out Exxon refinery in Kingston in a curious case of "reverse divestment."

1983

Seaga experiments with a five-tier foreign exchange system:

Effort fails.

A restrictive foreign exchange auction mechanism is introduced:

Rates initially unified at the parallel rate of J$3.15:US$1.

U.S. invades Granada; Seaga plays a major supportive role.

Capitalizing on his post-Granada political popularity, Seaga calls "snap" elections, which are boycotted by the opposition PNP:

Seaga and JLP win another five-year term in office.

1984

U.S. government's Caribbean Basin Initiative, providing trade preferences to qualified countries in the region, goes into effect.

Establishment of the Montego Bay free-trade zone; five other new trade zones are established over the next few years to encourage investment in light manufacturing and assembly operations.

In November, restrictions on currency bidding are removed; Jamaican dollar is allowed to float freely:

A forward foreign exchange system is introduced.

1985

Exchange rate slips to J$6.4:US$1:

Government begins to intervene heavily
Rate strengthens to J$5.5.

Government re-opens mothballed aluminum smelter.

Economic progress stumbles:

GDP falls 5 percent
Spending and fiscal problems worsen
Inflation hits 26 percent.

1986

Jamaica enjoys benefits of world oil price collapse.

U.S. government liberalizes market access for Caribbean Basin garment exporters.

Canada unveils its own CBI-type trade plan for the region.

New series of reforms and stabilization measures:

Tariffs rationalized and reduced to maximum level of 60 percent (by mid-1988); effective tariff rates average 35-40 percent
Tax system is reformed
New spending cuts undertaken.

Inflation falls to 15 percent from 26 percent in 1985.

1987

Inflation falls to annual average rate of 6.7 percent from 15.1 percent in 1986.

IMF grants standby credit.

Two World Bank sectoral adjustment loans granted.

Government divestment effort registers respectable gains.

Unemployment declines in 1986 and 1987, but still remains high.

Industrial modernization program launched to build efficiency and competitiveness in preparation for coming trade liberalization.

Government launches debt-equity conversion program:

$63 million in conversions approved through 1988.

1988

Government reaches agreement with aluminum companies on reduction of production levy in exchange for agreement to operate plants at full capacity.

Jamaica suffers extensive damage after being hit by Hurricane Gilbert:

Housing and infrastructure in need of extensive repairs
Major reconstruction effort begun
Aluminum operations interrupted; output falls 7 percent as a result.

1989

Both PNP and JLP take measures to control and discourage political violence; result is an unusually calm political campaign.

PNP returned to power under leadership of Michael Manley:

Manley advances a conservative program of economic continuity.

Currency allowed to depreciate by 18 percent, after a prolonged period of over-valuation.

1990

Michael Manley government signs a 15-month standby agreement with the IMF. Measures adopted in response include:

Exchange rate correction; rate pegged at J$7.1:US$1, after a 7 percent devaluation
Tax increases on motor vehicles and introduction of a General Consumption Tax
Removal of subsidies on basic foods
Hikes in public utility tariffs
12.6 percent guideline on wage increases
Reduction in government spending
Limits on wage increases
Export licensing abolished for 22 tariff items.

Jamaica fails two of eight economic performance criteria set by the IMF; program is suspended.

Select investment incentives passed:

Duty-free provisions granted to expatriate Jamaicans wishing to undertake new investments in Jamaica.

In May, Prime Minister Manley's health deteriorates; he is ordered to stay away from government activity for five months.

Exchange controls are liberalized:

Foreign currency savings accounts are now sanctioned
These accounts are exempted from withholding tax on interest applicable to local currency accounts.

Gulf crisis creates economic uncertainty related to oil prices and fears of depressed world demand for Jamaica's exports.

Jamaica abandons fixed exchange rate after only six months:

Commercial banks now authorized to independently buy and sell foreign exchange; interbank foreign exchange market now exists
But banks must sell 25 percent of their hard currency intake to the Central Bank
Jamaican dollar falls to J$8.07:US$1 by year-end.

IMF program is reinstated after Jamaica agrees to clear debt arrears to official and private creditors by March 1991.

III. Analysis of the Reforms

A. Timing

- **Restrained economic adjustment policies in Jamaica were adopted by the new government of Edward Seaga soon after it came to power in 1980.** Seaga inherited an acutely weak economy. Yet, political tensions lingering from the violence-filled 1980 elections did not create propitious conditions for drastic, austere policy reform. Expectations were widespread, in fact, that economic conditions would improve under the new government. Thus, Seaga opted initially for a program resembling a middle course: an orthodox stabilization program but modified to avoid potentially destabilizing policies — in particular, a devaluation of the Jamaican currency. Eventually, however, Seaga would have to commit to politically unpopular measures, for which his popularity would suffer.

- **Jamaica's resolve in following the reform path was renewed in 1986.** The year 1985 has been characterized by the World Bank as a watershed for Jamaica. The reform program had veered off course, economic growth had plunged by 5 percent, unemployment remained high, and no progress had been made on the fiscal deficit. The Seaga team then, in 1986, intensified the reform effort by reforming the tax system, rationalizing and lowering tariffs and reducing current expenditures.

- **The Seaga government's decision to broaden and deepen the reform effort starting in 1986 benefited from a favorable turn in external conditions.** Jamaica's terms of trade improved sharply, as oil prices fell followed by the rising of bauxite prices. Also, the North American economies remained generally healthy, thus helping the island's important tourist industry.

- **Fear of losing IMF financial support may in part explain Jamaica's aggressive actions in the second half of 1990.** The Manley government apparently anticipated new IMF prescriptions and, in the interest of resuscitating its suspended agreement, enacted a series of hard-hitting reforms. Particularly bold, was the liberalization of the exchange rate.

B. Sequencing

- **Jamaica's economic reform history since 1980 does not suggest a coherent evolution of policies based on clear-cut national priorities.** Many of the supposed priority reforms of the early 1980s — e.g., creation of a stable foreign exchange market, improved fiscal management, etc. — remained unfulfilled goals at the end of the decade. To some extent, an exception to this would be privatization, which was one of the most important lead reforms. Privatization was undertaken early in the Seaga administration and continued to be a top priority throughout Seaga's term.

- **Seaga's initial trade liberalization moves were tepid,** perhaps because of concerns that external conditions did not allow anything but a very cautious approach. When decisive trade liberalization steps were taken, Jamaica was enjoying clearly improved terms of trade conditions.

- **Jamaica had several different foreign exchange systems during the reform period.** Officials alternated between varieties of fixed and floating exchange systems, in accordance with external conditions and policy expectations of the IMF. In general, authorities did not at any time allow the Jamaican dollar to grow seriously overvalued. By avoiding destabilizing maxi-devaluations, officials engendered confidence in the foreign exchange system, which in turn allowed more ambitious liberalization than was previously possible under nervous and uncertain market conditions.

Structural Reform Matrix (SRM)
Worksheet for Jamaica

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1975-1979		Reform Period 1980-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	70%	6.3
		Low and Uniform Tariff Barriers	6	40%	2.4	70%	4.2
		No Local Content Regulations	4	60%	2.4	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	60%	5.4	70%	6.3
		Minimal Exchange Controls	5	40%	2.0	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	60%	4.2
		Minimal Preferential Interest Rates	1	30%	0.3	60%	0.6
		Equal Access to Capital	3	30%	0.9	50%	1.5
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	70%	4.9
		Minimal Subsidies	4	40%	1.6	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	50%	3.0
		Reduced Marginal Tax Rate	2	30%	0.6	70%	1.4
		Equitable / Uniform Tax Collection	2	50%	1.0	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	80%	4.0
		Franchise Out State Services	2	30%	0.6	80%	1.6
		Simulated Privatization	3	20%	0.6	80%	2.4
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	80%	4.8
		Proactive Promotion	1	20%	0.2	80%	0.8
2	Information	Free Flow of Market Information	2	70%	1.4	80%	1.6
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2
		Efficient Gov. Administration	2	40%	0.8	60%	1.2
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	40%	1.2	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	39.1	39.9	69.6	69.8

JAMAICA

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT															
Real % Change in GDP:	-0.3	-6.5	-2.4	0.5	-1.8	-5.7	2.6	1.2	2.7	-0.9	-4.6	1.7	6.2	1.5	4.6
By sector: Agriculture	1.7	0.7	2.9	9.6	-10.3	-4.3	2.2	-7.9	7.2	10.1	-3.5	-2.1	2.5	-4.4	--
Industrial Activity	-4.0	-11.6	-6.0	-1.2	-3.2	-9.5	1.1	-2.0	2.9	-3.6	-6.7	4.5	6.9	1.2	--
Services	2.0	-4.1	-0.9	0.2	0.3	-4.0	3.5	4.0	1.4	-1.0	-3.9	1.3	4.8	1.0	--
Per Cap. GNP-Current US $	1240	1310	1420	1390	1260	1140	1220	1290	1350	1140	900	860	940	1060	1140
PURCHASING POWER PARITY COMPARISON															
Income Index, US=100	23.83	20.51	18.28	18.14	17.54	16.29	15.24	15.83	15.72	14.38	13.42	13.70	13.38	13.09	12.82
Purchasing Index, US=100	82.29	93.59	106.28	77.13	65.10	72.39	74.33	75.25	78.57	49.90	42.71	47.93	49.24	50.02	51.98
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)															
Imports (cif) (1980 prices)	2.00	1.62	1.48	1.35	1.18	1.10	1.43	1.42	1.64	1.23	1.25	1.13	1.29	1.42	--
Exports (fob) (1980 prices)	1.20	0.95	1.04	0.98	0.96	0.96	1.01	0.82	0.80	0.82	0.64	0.64	0.69	0.76	--
Current Account	-0.28	-0.30	-0.04	-0.05	-0.14	-0.17	-0.34	-0.41	-0.36	-0.34	-0.30	-0.04	-0.14	0.08	-0.21
Capital Account	0.18	0.08	-0.03	-0.11	-0.01	0.08	0.05	0.29	-0.003	0.49	0.25	-0.02	0.40	--	--
Changes in Reserves	0.04	0.19	0.01	0.06	0.17	-0.08	0.19	0.09	0.12	-0.07	0.004	0.04	-0.08	-0.17	-0.05
External Debt	1.61	1.45	1.68	1.42	1.71	1.90	2.30	2.84	3.31	3.47	3.88	4.02	4.54	4.30	--
Interest Payments (on foreign debt)	0.05	0.05	0.06	0.07	0.09	0.11	0.10	0.14	0.15	0.19	0.21	0.22	0.22	0.22	0.26
Export Growth %	10.2	-20.5	9.0	-5.8	-3.9	2.4	4.5	-18.8	-2.0	2.5	-21.7	-0.9	8.3	10.4	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

JAMAICA

Terms of Trade % Change	-5.0	1.6	9.0	-9.1	-5.4	-9.4	-5.7	-0.7	1.5	-0.2	0.3	15.1	-8.3	-3.4	--

Pre-Reform Period

Reform Period

Estimated

JAMAICA

OTHER KEY INDICATORS	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	17.4	9.8	11.2	34.9	29.1	27.3	12.7	6.5	11.6	27.8	25.7	15.1	6.7	8.3	14.3
Fiscal Deficit (-)/Surplus as a % of GDP	-9.6	-14.3	-15.7	-13.2	-12.3	-15.1	-13.2	-14.5	-7.9	-11.0	-17.9	-11.4	--	--	--
Investment Share of GDP %	25.8	18.2	12.2	15.0	19.2	15.7	20.4	20.9	22.3	23.0	25.0	18.5	27.1	27.1	--
Savings Share of GDP %	15.4	9.4	10.8	16.4	17.7	13.6	10.0	9.3	10.2	16.4	14.7	20.7	22.9	18.7	--
Unemployment %	20.5	22.4	24.2	24.5	31.1	26.6	25.6	27.9	28.0	26.2	--	--	--	--	--
Real Wage Index[1] 1980=100	130.0	136.0	147.0	133.0	108.0	100.0	--	--	--	--	--	--	--	--	--
Government Share in Economy %[2]	22.3	28.2	28.5	48.1	42.9	48.8	49.3	43.3	41.6	43.1	48.8	41.4	--	--	--
Gross New Foreign Investment (US mn$)	-1.9	-0.6	-9.7	-24.5	-24.8	27.7	-11.6	-15.8	-18.7	12.2	-9.0	-4.6	53.4	-12.0	28.1

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MEXICO

MEXICO

General Assessment of Reform

- **Mexico's structural reform efforts since 1985-86 have been extremely ambitious.** They have encompassed trade and financial market liberalization, privatization, and foreign investment reform. In Latin America, only Chile has gone further toward opening up and restructuring its economy along market lines.

- **In general, implementation of reform measures has been intense.** This is particularly true of the actions taken by President Carlos Salinas de Gortari, who has embraced a bold, rather than a gradualist, approach to structural reform.

- **Reform efforts have produced tangible structural improvements in Mexico's economy.** The more competitive peso has attenuated dependency on oil exports and fostered growth in outward-oriented sectors such as export manufactures, in-bond assembly, and tourism. Privatization has reduced the state sector. Trade liberalization has significantly opened up the Mexican economy and has helped bring local prices in line with international prices. Also, fiscal reform has resulted in a substantially lower budget deficit and has reduced inflationary pressures.

- **Mexico has yet to realize clear-cut economic recovery.** The combined actions of the De la Madrid and Salinas administrations have brought about stability and important structural change, but not, as yet, significant job creation and growth. Moreover, real incomes are estimated to have fallen by some 40 percent since the onset of stabilization policies in 1982.

- **Foreign investment has picked up as the Mexican economy has stabilized, but not nearly as quickly as officials had hoped.** A stimulus for some new foreign investment projects has been debt-equity swaps. Beyond this, officials hope an eventual free-trade agreement with the U.S. will spur more extensive foreign direct investment.

- **Strong executive leadership has greatly advanced Mexico's reform effort.** Salinas' aggressive approach to structural reform won him important political points at a time when opposition activity could have derailed the reform effort. Meanwhile, the gradual liberalization and modernization of the political system have

given the opposition on the left and the right a greater voice in the legislature and a higher profile in public forums.

- **A high measure of political and ideological continuity has contributed significantly to Mexico's structural reform efforts.** Carlos Salinas was one of De la Madrid's top economic officials and a major force behind the early liberalization efforts. Although members of the long-ruling Institutional Revolutionary Party (PRI), De la Madrid and Salinas represent a new generation of political leadership who share a global, liberal and free-market perspective on economic management that is distinct from the past.

- **Directly and indirectly, the U.S. government has been a key source of support for Mexico's reform efforts.** The U.S. offered funds at critical periods of Mexico's adjustment and played an important intermediary role in Mexico's debt negotiations. Opportunities for expanded trade and integration with the U.S. seem to have been an important impetus for Mexico's economic liberalization.

I. Background to Reform

In late 1982, the new administration under President Miguel de la Madrid Hurtado, adopted an emergency adjustment program. Initially, the chief priority of this adjustment effort was securing external stability. Market-based reforms, particularly in the trade, government spending and pricing areas, were timid. The public sector remained bloated, and government intervention in the economy continued to be widespread.

Structural reform began earnestly in 1986, when the collapse of the world oil market forced the De la Madrid administration to undertake a new stabilization program. The effort went beyond mere stabilization to encompass accelerated trade liberalization, price reform, and privatization. At the close of his term, De la Madrid introduced a heterodox wage/price program to control inflation. His successor, Carlos Salinas, has maintained the price program while intensifying the structural reform process.

II. Evolution and Chronology of Mexico's Economic Reform

1982

Mexico unable to service its foreign debt. Newly inaugurated President Miguel de la Madrid enacts widespread emergency measures to stabilize economy.

1983

Economy stabilizes, but deep recession follows in 1984.

1984

Fiscal and monetary policy eased as midterm elections approach.

1985

Ruling party scores major victories in midterm vote but fraud charges alleged.

Government spending cuts and trade liberalization interrupted by massive earthquakes.

1986

World oil prices collapse; De la Madrid outlines key features of new adjustment strategy:

- Renegotiation of foreign debt
- Cut spending and boost government finances
- Promote non-oil exports
- Rationalize price controls and subsidies.

Rationalization of price control system.

Expansion of export incentives.

Negotiations begun with trading partners in preparation for GATT entry.

Revision of government budgets and implementation of spending cuts.

Acceleration of tax payments; increase in select rates and reduction in incentives.

Reduction in tariff rates and reference prices on imports.

Start of debt-for-equity swap program.

Acceleration of approvals for export-based foreign investments.

1987

Sale of minority shares in 19 government-owned commercial banks.

Formal accession to the GATT:

- Agreement to eventual elimination of import-licensing requirements
- Substantial reduction and rationalization of tariffs.

Extension of product patent protection to pharmaceuticals, chemicals, animal foods, and beverages:

- Streamlining of bureaucratic procedures for patents and trademarks.

Expansion of tax base through major reform effort:

- Inflation adjustment of income and deductions
- Reduction of corporate tax rate from 42 percent to 35 percent.

Easing of commercial banks' reserve requirements.

Foreign companies allowed to re-enter bond market.

Announcement of new anti-inflation initiatives:

- Faster import liberalization
- Slower peso depreciation.

Bilateral Framework Agreement with U.S. signed.

Post-stock-market crash stabilization measures announced as part of new "Economic Solidarity Pact":

- Withdrawal of support for free-market peso and major devaluation of the controlled rate peso
- Major increases in controlled prices and cuts in subsidies
- Cut 50 percent of maximum tariffs (to 25 percent); average 25 percent reductions in all duty rates
- Budget cuts equivalent to 2.5 percent of GDP announced
- Temporary freeze on wage hikes.

1988

New debt-for-bonds scheme announced.

Privatization push greatly accelerated.

Second phase of PSE enacted:

Controlled exchange rate frozen from March to December
Prices on controlled goods frozen; increases on all others negotiated between government and industry
Wage increases kept minimal
Interest rates forced down.

Mild improvements in patents and trademark rules.

Ruling party claims victory in controversial midterm elections; widespread fraud alleged.

New round of stabilization measures undertaken to compensate for falling oil prices:

New budget cuts
Liquidation of state companies and new privatizations
Interest rates allowed to rise.

1989

Pact for Stability and Economic Growth (PECE) replaces Economic Solidarity Pact:

One-peso-per-day mini-devaluations
Modest 8 percent minimum wage hike
"Voluntary" price restraint
Austere spending plan.

New tax reform introduced:

2 percent asset tax introduced
50 percent dividend withholding tax repealed; cuts in withholding rates on other foreign payments
Corporate and personal tax rates cut.

Extensive revision of foreign investment statute:

New sectors opened up to 100 percent foreign ownership
Automatic approval allowed for specified investments.

Basic petrochemical sector opened to private investment.

Exchange rate and price policies adjusted

One peso per day devaluation replaces freeze
Controlled prices remained effectively frozen but some adjustments made
In June, PECE extended to March 31, 1990.

Privatization of Mexicana airlines; start of partial privatization of Telmex and increased competition in value-added telecom services encouraged. Cananea copper mine closed.

Domestic trucking industry liberalized and many container and packaging requirements scrapped.

Extension of remaining import licensing requirements, to the end of 1990.

Extension of PECE, to July 1990:

No change in exchange rate policy
Price controls further relaxed to avert shortages
Producer guaranteed prices for farmers hiked, without corresponding hike at retail level
Structural reform of the financial sector intensified. Freeing of interest rates and lowering of banks' reserve requirements from 90 percent to 30 percent. Also announced plans to merge the eight development banks and tighten rules on overdue loans and loan portfolio management; supported by a $500 million World Bank credit
Major new infrastructure projects launched
Import and local content rules for automotive sector liberalized
Activities of state food marketing chain rationalized and prioritized.

1990

Mexico signs historic debt-reduction agreement with its 500 commercial bank creditors under the so-called Brady Plan for LDC debt-reduction. Mexico's total foreign debt is cut by about 10 percent.

Reprivatization of nationalized banking system announced.

Mexico announces goal of a free-trade agreement with the U.S.

PECE is extended to 1991.

III. Analysis of the Reforms

A. Timing

- **Economic reforms were begun in Mexico in 1982, initially in response to the nation's debt and balance-of-payments crisis.** But, the initial policy moves were designed to restore stability, not fundamentally change the structure of the economy.

- **A clear shift to structurally oriented, market-based policies did not occur until after the midpoint of De la Madrid's term.** It is noteworthy that policymakers opted not to initiate far-reaching reforms before the mid-term elections in 1985. In fact, there was a distinct relaxation of fiscal discipline prior to the midterm elections held in mid-1985.

- **The retrenchment that took shape in the post-election period was cut short by the September 1985 earthquakes.** The pivotal event that forced a fundamental re-thinking of economic strategy was the massive world oil price drop of early 1986, which hit Mexico particularly hard and put to rest any hope that the country could "muddle through" the crisis.

- **The earthquakes and oil price shock did not, as predicted, force a postponement of reform.** In fact, De la Madrid went forward with a new program, backed by an IMF standby arrangement. His decision to open up the economy and pursue GATT membership was bold and unexpected.

- **Mexico's external accounts improved quickly during 1986-87.** Climbing foreign reserves allowed De la Madrid to aggressively pursue reform goals, including GATT membership.

- **The crash of the Mexican stock market in late 1987 started a new reform phase.** The government's response to this — the Economic Solidarity Pact — was an attempt to continue and even accelerate the overall structural reform process while reversing the inflationary tide.

- **Carlos Salinas de Gortari did not let the controversy surrounding his mid-1988 election undermine his ability to continue the heterodox policies and market-based reforms begun under De la Madrid.** Nor did periodic labor flare-ups cause a perceptible deviation in policy. Salinas moved boldly on major fronts, in more than a few instances, directly confronting powerful labor interests. Major new reforms in foreign

investment, deregulation, and privatization were initiated in 1989, Salinas' first full year in office.

- **World events since 1988 have put pressure on Salinas to accelerate economic liberalization and North American integration efforts.** In particular, Eastern Europe is perceived as competing for investment capital and technology. Mexico needs both of these to achieve its modernization goals. A formal trade agreement with the U.S. and Canada is viewed as a means of securing these.

B. Sequencing

- **There was no clear lead policy reform in Mexico. De la Madrid initiated reform moves in all major policy reform areas in 1986.** Fiscal and tax reform measures were prominent that year, as were changes in exchange rate management — both of these in response to the effects of the oil market downturn. With support from the IMF and sufficient balance-of-payments stability, Mexico aggressively pursued GATT membership, which served to institutionalize the nation's commitment to freer trade, more open foreign investment rules, and closer economic integration with the United States.

- **Starting in late 1987, Mexico's use of controls on wages, prices, and the exchange rate to stem inflation, marked a deviation from a more orthodox, market-based approach.**

- **This heterodox phase, which would continue into 1990, did not undermine the broader reform effort; structural reform and price policies coexisted.** Importantly, while appreciating significantly against the dollar in 1988-89, the peso did not grow overvalued. Also, officials maintained positive real interest rates (not only to boost savings but also to discourage dollar purchases and capital flight). Furthermore, officials accelerated trade liberalization to spur industrial modernization and to reduce pressure on prices.

- **The Mexican government's most aggressive moves in foreign investment reform and privatization occurred in the latter part of the reform period — after the 1988 presidential election.** Had it attempted to implement these liberalization moves before the election, the government would have been extremely vulnerable to criticism at the hands of the nationalistic opposition.

- **Neither De la Madrid nor Salinas attempted to run his respective heterodox programs without critical backing from business and mainstream labor.** The Mexican government engaged representatives of both these groups in negotiations over the terms of these programs. The government clearly has wanted to avoid labor troubles and business resistance to the reforms. In general, the government has succeeded in convincing these groups to buy into the program.

Structural Reform Matrix (SRM)
Worksheet for Mexico

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1985		Reform Period 1986-1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	40%	2.4	90%	5.4
		No Local Content Regulations	4	30%	1.2	70%	2.8
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	70%	6.3
		Minimal Exchange Controls	5	30%	1.5	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	80%	5.6
		Minimal Preferential Interest Rates	1	30%	0.3	90%	0.9
		Equal Access to Capital	3	40%	1.2	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	60%	4.2
		Minimal Subsidies	4	20%	0.8	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	70%	4.2
		Reduced Marginal Tax Rate	2	40%	0.8	80%	1.6
		Equitable / Uniform Tax Collection	2	30%	0.6	70%	1.4
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	80%	4.0
		Franchise Out State Services	2	20%	0.4	60%	1.2
		Simulated Privatization	3	10%	0.3	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	70%	4.2
		Proactive Promotion	1	60%	0.6	90%	0.9
2	Information	Free Flow of Market Information	2	40%	0.8	60%	1.2
16	Enabling Environment	Private Property Rights	9	70%	6.3	80%	7.2
		Efficient Gov. Administration	2	50%	1.0	70%	1.4
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	70%	2.1	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	37.4	37.1	73.9	74.3

MEXICO

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP (1980):	8.3	7.9	-0.6	05.3	3.7	2.7	-3.7	1.4	1.1	2.9
By sector: Agriculture	7.1	6.1	-2.0	2.0	2.7	3.1	-1.4	1.1	-1.6	--
Industrial Activity	9.5	9.0	-2.1	-8.9	4.7	4.8	-5.9	2.7	1.2	--
Services	7.9	9.0	0.4	-2.4	3.2	1.4	-3.0	0.9	1.4	--
Per Cap. GDP-Current US $	2320	3000	2820	2290	2130	2180	1890	1770	1770	2282
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	38.00	38.98	37.99	32.97	30.69	29.51	31.52	34.89	35.91	35.17
Purchasing Index, US=100	59.36	64.27	43.17	36.99	43.08	44.03	47.36	51.38	34.34	29.60
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	-19.5	-24.3	-15.7	-8.5	-12.7	-15.4	-11.9	-11.3	-16.1	--
Exports (fob) (1980 prices)	15.3	18.9	21.3	24.2	26.5	24.9	24.3	25.3	25.5	--
Current Account	-10.7	-16.1	-6.3	5.4	4.2	1.1	-1.6	3.9	-2.9	--
Capital Account	11.6	17.3	-5.3	-9.7	-4.9	-4.8	1.5	1.6	-3.7	--
Changes in Reserves	-1.1	-1.3	3.5	-2.2	-2.3	2.9	0.2	-5.7	6.8	--
External Debt	57.5	78.3	86.1	92.9	94.8	96.8	100.9	109.3	101.6	95.8
Interest Payments (on foreign debt)	3.9	4.8	6.2	6.6	10.2	9.4	7.6	7.7	7.6	7.9
Export Growth %	34.2	23.5	12.7	13.6	9.5	-6.0	-2.4	4.1	0.8	--
Terms of Trade % Change	16.0	6.9	-2.9	-6.1	1.0	-0.8	-32.4	10.9	-8.7	--

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

MEXICO

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	26.4	27.9	58.9	101.9	65.5	57.7	86.2	131.8	114.2	20.0
Fiscal Deficit (-)/Surplus as a % of GDP	3.0	6.4	14.8	7.6	7.1	8.4	13.1	9.4	--	5.8
Investment Share of GDP %	2.8	3.6	4.8	8.1	13.2	22.0	32.8	--	--	--
Savings Share of GDP %	2.2	2.8	4.6	9.7	14.7	22.4	30.9	--	--	--
Unemployment %	4.5	4.2	4.2	6.7	5.7	4.5	17.8	18.0	--	--
Real Wage Index[1] 1980=100	100.0	103.0	100.6	74.5	72.6	90.9	86.8	--	--	--
Government Share in Economy %[2]	17.3	20.0	30.7	27.8	24.3	26.1	30.4	23.7	--	--
Gross New Foreign Investment (US mn$)	2148.0	2541.0	1655.0	461.0	390.0	491.0	1523.0	3246.0	2594.0	2241.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

PERU

PERU

General Assessment of Reform

- **Peru has only now, under President Alberto Fujimori, begun to deal with the immense structural problems in its economy.** In the mid-1980s, while many other Latin American countries were beginning to take steps to put their economies on a less-regulated, more free- market footing, Peru's President Alan Garcia took the opposite tack with highly expansionary, interventionist policies that created a whole new set of economic problems. The Peruvian economy under Garcia grew notably more controlled and distorted.

- **Garcia's plan was very much a "home brew." It was presumably conceived without IMF and World Bank input and guidance.** Lacking an IMF agreement, Peru did not have this outside source of discipline to guide policy decisions.

- **Garcia's "Plan de Emergencia" was totally short-sighted.** It produced a very short term boom that did not anticipate the problems resulting from excess demand. Particularly absent was a strategy to deal with growing fiscal imbalances. The period of 1986-89 witnessed an ever widening public enterprise sector deficit. A second phase, which was supposed to be centered on investment and export growth, never emerged.

- **The failure of the original stabilization effort resulted in more economic restrictions.** For example, as Peru's foreign exchange reserves dwindled, import restrictions grew more onerous and the foreign exchange system became more irrational and complicated.

- **Garcia's actions did little to convince private investors that the government was supportive of their activities.** The takeover of Belco and attempted nationalization of the banking system destroyed the president's credibility in the business sector. The investment environment was further poisoned by political unrest and guerrilla activities, which escalated during the mid- and late-1980s.

- **By any measure, the economic consequences of Garcia's policies were disastrous.** After the demand-led boom of 1986-87, real gross domestic product contracted by an annual average of 8 percent between 1988 and 1990. Per capita income in that period

fell by more than 10 percent yearly. Inflation soared to 1,700 percent in 1988; 2,800 in 1989; and an estimated 8,200 in 1990. By the end of Garcia's term, real average wages were only about half as high as when he took office.

- **Peru's terms-of-trade during the Garcia period were not favorable.** Thus, stabilization and adjustment would have been difficult under the most prudent of policies. At the same time, however, the Peruvian economy benefited to some extent from illegal receipts from drug- trafficking.

- **New foreign investment has been a major victim of Peru's political and economic turbulence.** Peru's record on attracting new investment has been dismal. Even before Garcia came to power, foreign investment in Peru had grown by a mere 8 percent (annual average) between 1975 and 1984— the lowest rate recorded by any Andean Pact country. The rate fell further, to 2.5 percent, between 1984 and 1987.

- **Fiscal reform is widely considered Alberto Fujimori's greatest challenge,** and many analysts say this will not succeed without a vigorous reform of the state enterprise sector. Massive structural changes in tax administration are also considered fundamental, particularly given the immense size of Peru's informal economy.

I. Background to Reform

In the early 1980s, the Peruvian economy was adversely affected by several external shocks, including a sharp decline in its terms of trade and rising international interest rates, which significantly increased the nation's foreign debt burden. Peru's problems were compounded by ineffective policies by the government of Fernando Belaunde (who was elected president in 1980 after 12 years of military rule) and by a series of natural disasters, including floods, droughts, and changes in the sea currents. A 1982 standby agreement with the IMF failed to stem the tide of economic decline. Nor did a last-ditch orthodox economic program by the Belaunde government succeed in restoring stability. The political result of this was a sweeping victory by the popular social democrat candidate Alan Garcia in the 1985 election. Garcia launched a radical economic program aimed at controlling inflation and limiting Peru's external-debt payments.

II. Evolution and Chronology of Peru's Economic Reform

1980

Election of Fernando Belaunde Terry as president marks Peru's return to democratic constitutional rule, after 12 years of military government.

Initial economic policy direction centers on control of inflation:

- Subsidies are reduced
- Unsuccessful attempts to cut capital spending
- Import liberalization promoted
- Restrictive monetary policy.

1981

Fiscal problems persist.

External pressure mounts:

- Peru's terms of trade decline
- Debt burden rises.

1982

IMF extended fund facility ($715 million) secured.

1983

Agricultural sector hurt by droughts and floods.

IMF agreement suspended owing to Peru's failure to meet policy prescriptions.

1984

Peru wins new $245 million IMF standby credit, but loan suspended again after only three months.

Orthodox stabilization program launched in midyear:

- Public sector deficit falls
- Exchange rate depreciates
- International reserves rise.

Protection of international reserves becomes policy priority:

- Trade liberalization suspended; import licensing introduced
- Currency devaluation accelerated

Foreign debt payments suspended.

Inflation continues to rise.

1985

Renewed efforts to cut fiscal deficit:

Taxes increased
Public sector investment reduced.

Economic performance worst since the 1930s.

Alan Garcia of center-left APRA party elected president in midyear.

Garcia implements radical heterodox economic program — "Plan de Emergencia" — with widespread public support:

Exchange rate devalued and then frozen; multiple rates established
Prices and wages raised, then frozen
Interest rates reduced
Foreign currency deposits frozen
Service of medium and long-term public debt limited to 10 percent of export earnings (of goods and financial services).

Peruvian government seizes Belco oil company on grounds of inadequate investment.

1986

Policy priority shifts from price stability to recovery:

Wages raised in real terms (by 34 percent between August 1985 and December 1986)
Wide range of imports banned to encourage import substitution
Monetary and fiscal controls eased
Subsidies restructured to favor consumption
Interest rates continuously cut
Slight thaw in price controls
Introduction of multi-tier exchange rate
Some effort to attract foreign investment.

Recovery effort produces disastrous results:

Imports shoot up

Current account deficit returns.

Inflation falls significantly, from 163 percent in 1985 to 78 percent.

After more flexible price policy implemented, controls retightened at year-end.

Mounting arrears render Peru ineligible for IMF funding.

1987

Government orders profitable private firms to buy low-interest "mandatory bonds."

Government initiative to nationalize commercial banks, finance companies and insurance companies:

Original intent to nationalize 70 percent of bank shares
Actual results less sweeping due to significant loopholes and exemptions.

Universal foreign exchange controls implemented:

Parallel foreign exchange market suspended
Exchange rates devalued an average of 24 percent in October and another 47 percent in December
Exchange rate system rationalized; number applicable to exports reduced from nine to three, and later to two
All imports made subject to foreign exchange licenses and strict quotas
Profit remittances banned for two years.

Large subsidy scheme— Fondo de Inversion y Empleo— created for priority investments outside Lima.

Wage increases decreed at regular intervals (about every four months).

Overall real prices at about 50 percent of July 1985 levels.

Major deterioration in public finances:

Tax proceeds decline from 11 percent to 9 percent of GDP
Ratio of public investment to GDP falls to lowest level in a decade.

Government revises Petroleum Law to encourage foreign investment in energy sector.

1988

Peru enters hyper-inflationary spiral; inflation skyrockets to 1,600 percent.

Policy shifts again toward a more orthodox approach:

Sales tax hiked, from 6 to 10 percent
List of goods subject to consumption (excise) taxes hiked.

Central Bank starts monthly devaluation of exchange rate applicable to exports; import rate lags, thus widening the spread.

Interest rates hiked, but fall greatly below inflation rates:

Rates for agricultural credits heavily subsidized.

In March, a new economic package is announced:

22-50 percent increase in public sector prices and tariffs
Wage hikes in the 40-60 percent range, followed by a 120-day freeze.

Haphazard and reactive adjustments in public sector prices, wages, and the exchange rate during second half of the year:

Public sector prices rise to only about 30-50 percent of market rate
Government deficit aggravated
Exchange rate regime made more complicated with introduction of new exchange rates.

Inflation rises to nearly 3,000 percent in 1989.

Peru inaugurates debt-equity swap program.

1989

Government rejects an IMF stabilization plan in favor of a gradual, home-grown approach.

Central Bank transfers imports of industrial inputs to the parallel exchange rate.

The 6 percent tax on exports is abolished.

Series of price and wage adjustments in March-April.

Minimum wage is hiked by 40 percent at midyear.

"No questions asked" tax amnesty offered.

New tax incentives to encourage exports.

Conservatives score victories in November local elections.

Increase in terrorism by Shining Path and Tupac Amaru guerrilla groups; significant damage to infrastructure.

First commercial-free zone created in the southern department of Tacna.

Peru approves Andean Pact Decision 220, liberalizing foreign investment rules and procedures.

Year-end run on currency prompts emergency foreign exchange measures:

- Start of future sales of official rate dollars
- Speed-up of daily mini-devaluations
- Temporary suspension of gold purchases.

Peru resumes debt-service payments to IMF in December.

1990

Dark horse candidate, Alberto Fujimori, wins April presidential vote after campaigning on a "no shock" platform:

- But Fujimori's "Cambio 90" party has fewer than one-quarter of the seats in Congress.

Severely tough new economic package implemented within two weeks of inauguration:

- Government commits to an extremely tight monetary policy (zero emission)
- Prices of subsidized and controlled-rate goods raised drastically overnight
- Three new taxes are introduced: a temporary 10 percent levy on exports; a tax on fuel consumption and a 2 percent tax on bank checks
- Minimum wage hiked by 300 percent
- Exchange rate freed.

Fujimori government makes fiscal and regulatory policy moves that attenuate regionalization efforts promoted by Garcia.

"Social compensation package" of emergency food rations given to economically vulnerable workers to compensate for the loss of purchasing power.

Government lifts restrictions on repatriation of profits.

New exchange rates introduced during second half of the year.

Major new stabilization package implemented in December:

Gasoline price hiked 63 percent
Government vows to bring currency to parity level within 90 days
Privatization program is announced for 1991.

Public reaction to latest stabilization measures is negative:

Private sector leaders criticize "lack of clearness and transparency"
Politicians criticize absence of communication with Congress.

III. Analysis of the Reforms

A. Timing

- **In his initial stabilization effort, Alan Garcia enjoyed the advantage of being a new president, and a very popular one.** Garcia was elected by an overwhelming majority. His APRA party also had absolute majorities in both legislative houses. Garcia had a clear mandate for change.

- **Macroeconomic conditions were hardly favorable when "Plan de Emergencia" was launched, but they could have been worse.** The outgoing Belaunde administration left Garcia's team relatively high levels of international reserves, a competitive exchange rate, and generally adequate public sector prices.

- **On the negative side, the political environment was deeply troubled.** When Garcia took power, Peru was suffering from widespread and continuous labor strikes, as well as from violent actions in urban areas by terrorist groups from the Andean Highlands.

- **By 1987, Garcia and his policies had suffered critical losses of credibility.** The price/wage and exchange rate freezes from 1985 to 1986 caused substantial economic distortions. The private sector was further alienated by increasing government incursions into the economy— in particular, the attempted nationalization of the Peruvian financial system.

- **The election of Alberto Fujimori in 1990 to the presidency represents another opportunity for Peru to commit to real structural economic reform.** However, Peru's domestic political environment remains severely troubled by labor unrest, sporadic guerrilla terrorism, and urban unrest. Moreover, Fujimori inherited a severely weakened economy, which was troubled by, among other things, severe drought conditions and shortages of critical inputs.

B. Sequencing

- **Garcia's emergency plan attempted a simultaneous economic reactivation and reduction in inflation.** His team enacted highly expansionary fiscal and monetary policies intended to utilize existing industrial capacity and to boost consumption. It also limited debt service to 10 percent of export revenues. The inflation-control aspect of the plan was addressed through a price and exchange rate freeze.

- **After about 18 months under the "Plan de Emergencia," Peru suffered from severe excess demand.** In 1987, the government took steps to correct growing distortions, but these did not form a coherent strategy. For example, the government devalued the currency but kept in place an unmanageable system of as many as nine exchange rates. Also, while devaluing the rate for exports, the government insufficiently adjusted the rate for imports. Meanwhile official price increases consistently lagged behind inflation.

- **Measures to liberalize the foreign investment environment emerged toward the close of Garcia's term.** However, due to the president's lack of credibility and the dismal state of the economy, foreign investment liberalization measures were largely ineffective.

Structural Reform Matrix (SRM)
Worksheet for Peru

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1988		Reform Period 1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	60%	5.4	20%	1.8
		Low and Uniform Tariff Barriers	6	60%	3.6	30%	1.8
		No Local Content Regulations	4	50%	2.0	30%	1.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	20%	1.8
		Minimal Exchange Controls	5	70%	3.5	10%	0.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	70%	4.9	20%	1.4
		Minimal Preferential Interest Rates	1	60%	0.6	30%	0.3
		Equal Access to Capital	3	60%	1.8	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	70%	4.9	20%	1.4
		Minimal Subsidies	4	70%	2.8	20%	0.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	60%	3.6	40%	2.4
		Reduced Marginal Tax Rate	2	50%	1.0	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	40%	2.0	20%	1.0
		Franchise Out State Services	2	40%	0.8	40%	0.8
		Simulated Privatization	3	60%	1.8	40%	1.2
7	Foreign Investment	Non-Discriminatory Treatment	6	60%	3.6	40%	2.4
		Proactive Promotion	1	60%	0.6	40%	0.4
2	Information	Free Flow of Market Information	2	70%	1.4	70%	1.4
16	Enabling Environment	Private Property Rights	9	70%	6.3	50%	4.5
		Efficient Gov. Administration	2	50%	1.0	50%	1.0
		Legal and Accounting System	2	60%	1.2	60%	1.2
		Infrastructure	3	50%	1.5	30%	0.9
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	58.3	59.8	35.2	31.1

PERU

GROSS PRODUCT	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Real % Change in GDP:	4.7	5.5	0.1	-12.3	5.1	1.5	10.0	7.8	-8.5	--
By sector: Agriculture	-6.4	9.0	3.0	-10.8	11.8	3.7	5.4	5.7	5.7	--
Industrial Activity	5.5	1.1	0.3	-15.4	4.5	2.8	10.3	9.7	-13.7	--
Services	6.3	6.5	-0.4	-10.0	3.3	1.7	9.9	6.7	-8.1	--
Per Cap. GDP-Current US $	990	1240	1380	1140	1120	1010	1130	1330	1300	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	21.54	20.91	20.61	17.49	16.96	15.92	15.78	17.01	16.39	15.91
Purchasing Index, US=100	47.46	53.21	50.10	42.88	40.90	32.97	37.95	43.38	50.13	48.45
EXTERNAL TRADE AND BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 Prices)	3.06	3.80	3.88	2.90	2.41	2.21	2.82	3.30	2.61	--
Exports (fob) (1980 Prices)	3.90	3.53	4.09	3.81	4.06	4.01	3.66	3.40	2.86	--
Current Account	-0.10	-1.73	-1.61	-0.88	-0.22	0.14	-1.03	-1.48	-1.10	0.51
Capital Account	0.37	0.96	1.42	-0.19	-1.34	-1.46	-1.09	-1.30	-1.12	--
Changes in Reserves	-0.61	0.63	0.07	-0.002	-0.30	-0.12	0.41	0.86	-0.05	-0.67
External Debt	10.04	10.32	12.29	11.99	13.05	14.17	15.99	18.12	18.58	--
Interest Payments (on foreign debt)	0.54	0.53	0.55	0.39	0.54	0.46	0.27	0.20	0.17	0.15
Export Growth %	-3.0	-9.5	-16.1	-6.8	6.5	-1.3	-8.6	-7.2	-15.7	--
Terms of Trade % Change	2.9	-7.9	-8.8	0.4	0.0	-4.1	-17.0	8.3	10.0	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

PERU

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	59.2	75.4	64.4	111.2	110.2	163.4	77.9	85.8	1636.0	2777.0
Fiscal Deficit (-)/Surplus as a % of GDP	-0.8	-3.8	-3.1	-4.3	-1.7	0.3	-3.4	-5.5	-2.5	--
Investment Share of GDP %	27.5	31.4	31.4	23.7	22.7	22.4	23.2	23.6	28.5	--
Savings Share of GDP %	27.5	25.4	25.7	22.7	26.4	27.0	21.1	20.4	24.1	--
Unemployment %	7.0	6.8	7.0	9.2	10.9	--	--	--	--	--
Real Wage Index[1] 1980=100	100.0	109.0	103.0	--	--	--	--	--	--	--
Government Share in Economy %[2]	13.9	13.5	11.7	13.2	11.7	12.1	12.6	11.9	2.0	--
Gross New Foreign Investment (US mn$)	27.3	128.5	48.0	38.0	-89.0	1.0	22.0	32.0	26.0	59.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

VENEZUELA

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General Assessment of Reform

- **The scope of Venezuela's economic reform program under President Carlos Andres Perez (CAP) has been wide.** Beyond macroeconomic stabilization, CAP is aiming to transform and diversify the economy, to become more open, market-driven and export-oriented. The role of the state is changing. The government recognizes the drain on public sector finance caused by inefficient public management and state enterprise. Yet, CAP's program does not call for an indiscriminate shrinking of the state, which will continue to be engaged in economic activities that are profitable, encourage private capital formation, and help achieve national development goals.

- **In general, implementation of structural policies has been vigorous,** but less so than, for example, the reform programs undertaken by Chile and Bolivia. The halting rhythm of the CAP's program would appear to be related to the political opposition that individual components of the reform effort have met. The February 1989 riots that resulted in more than 300 deaths sent a clear signal of caution to the government.

- **Venezuela's delay in enacting reform policies undoubtedly made adjustment after 1988 more painful.** If officials had cut spending and devalued the exchange rate after the 1986 oil price crash— or sooner— the austerity moves that had to be taken anyway might not have proved to be as severe. On the other hand, the fact that economic conditions were so desperate when he took office may have given CAP greater freedom to aggressively tackle the structural, as well as the immediate, problems afflicting the Venezuelan economy.

- **Key economic results of Venezuela's structural reform program are thus far encouraging.** On the fiscal side, the government deficit has been sharply reduced from 8 percent of GDP in 1988 to 1.7 percent of GDP in 1989. Inflation has been tamed; the rise in consumer prices slowed from 84 percent in 1989 to an estimated 32 percent in 1990. Venezuela's now more realistic exchange rate has helped restore equilibrium in its external accounts. The current account has improved from a deficit of almost $6 billion in 1988 to a surplus of $6 billion in 1990. As expected, adjustment and structural reform measures have produced recessionary conditions. Real GDP growth tumbled 8

percent in the first year of the program.

- **The Venezuelan government has been under consistently intense domestic political pressure to modify the program.** While the extent of opposition has varied from issue to issue and group to group, aspects of the program have been opposed by labor, local industrial groups, and by some foreign firms accustomed to a protected market. Opposition has also come from President Carlos Andres Perez's own Accion Democratica party.

- **The lack of a popular perception of crisis in the 1987-88 period may help explain the country's resistance to reform, according to one view.** By drawing down the nation's foreign exchange reserves, the Lusinchi government postponed needed adjustment measures and succeeded in maintaining widespread subsidies and a relatively protected economy. Since Venezuela's experience with austerity was very limited, it is not surprising that CAP's program has met fairly high levels of domestic opposition.

- **Venezuela's service sector is still restricted in many respects.** Restrictions limit foreign involvement in financial services, advertising, consulting, and communications/media. National implementing legislation limits foreign equity participation in these sectors to 20 percent.

- **Venezuela's short and medium-term economic prospects remain linked to world oil market conditions.** The nation is still in the early stages of reform. Progress toward economic diversification has been expectedly slow, as oil still accounts for some 80-85 percent of total export earnings and about 60 percent of fiscal revenue. In the short run at least, Venezuela has clearly benefited from the higher oil prices resulting from the Persian Gulf crisis. The oil price windfall could help accelerate the nation's economic recovery. The downside risk is that the windfall will tempt the government to seriously compromise its reform plan and not carry through with the structural changes needed for sustained stability and economic growth.

- **The IMF and World Bank's contributions to Venezuela's recovery and economic reform efforts have been significant.** Particularly important have been these institutions' help in enhancing debt and debt service operations. Venezuelan authorities had access to some $3.3 billion in official funds for debt-reduction operations.

I. Background to Reform

When the decade of the 1980s began, Venezuela enjoyed one of the fastest-growing economies in Latin America. However, the nation's economic well-being was largely driven by its immense oil wealth, which masked structural deficiencies and vulnerabilities in the economy. Among these were a heavy reliance upon petroleum revenues, deep-rooted government intervention in the economy, and a highly protected and insular domestic market. These problems were fully exposed when world oil prices tumbled, first in 1982, and then again in 1986. Venezuela, however, did not fully commit to genuine structural reform before the end of the decade, despite periodic (and often short-lived) adjustment programs.

Venezuela embarked on a path of structural economic reform soon after Carlos Andres Perez — "CAP" — was elected for a second term in late 1988. (CAP had previously served a presidential term during the oil-boom years of the 1970s.) The Perez reform program, while modified in some respects, continues into 1991.

II. Evolution and Chronology of Venezuela's Economic Reform

1979-82

Following an extended period of high growth and low inflation, problems beset the Venezuelan economy. Growth slows, inflation picks up, and the external sector weakens. Local financial markets turn jittery and capital flight worsens balance-of-payments pressures. Crisis erupts in 1983.

1983

Stabilization plan is enacted by outgoing Christian Democratic government:

Officials adopt multiple exchange rate to cope with the balance-of-payments crisis
Public spending (especially investment) is slashed
Non-tariff import prohibitions are extended
Rigid exchange controls are put in place
GDP growth falls by 5.6 percent.

1984

New administration of the social democrat (AD) party takes over:

Economy stabilizes, but recession continues
Fiscal surplus equal to 3.3 percent of GDP is registered
International reserves continue to build.

Official exchange rate is devalued again.

New public spending cuts are enacted.

1985

Economy continues to stabilize:

Government records a fiscal surplus of 5.1 percent of GDP
International reserves start to build up.

President Jaime Lusinchi initiates a program to reactivate the economy. Public sector investment rises by some 66 percent in real terms. GDP growth recovers. Real output increases by nearly 7 percent.

1986

Venezuela signs rescheduling agreement with commercial bank creditors, but agreement turns out to be nonviable.

World oil prices collapse. Current account deficit returns. Public sector balance turns into a deficit of nearly 5 percent.

Bolivar exchange rate is devalued by 93 percent.

1987

Government introduces debt-capitalization and debt-equity conversion programs to spur new investment and reduce government debt. Initial currency conversion terms of the programs are unattractive; investors show little interest.

Fiscal deficit of 3.4 percent is recorded.

Inflation more than doubles from 12 percent in 1986, to 28 percent.

1988

Benefits of debt-equity conversions are expanded; interest in the program picks up in second half of the year.

Economic conditions worsen. Fiscal deficit more than doubles, to 7.8 percent of GDP. Operating foreign exchange reserves are all but depleted. Currency grows seriously overvalued.

Carlos Andres Perez (CAP) of the social democratic Accion Democratica is elected to a five- year term. CAP is elected on a platform of economic renewal.

By year-end, government ceases selling foreign exchange at the highly overvalued official exchange rate. Shortages of basic goods become widespread.

1989

CAP implements an ambitious economic stabilization and reform program soon after his inauguration:

Venezuela adopts a unified, market-determined value for the currency. Official exchange rate of B14.5:$1 is abolished. This amounts to a 170 percent devaluation of the official exchange rate. Exchange controls are removed.

Fiscal policy is tightened. Petroleum prices are doubled. Telecommunications, electric power, and other public utility prices are significantly hiked.

Financial sector is reformed. Interest rates are greatly liberalized and made sensitive to market forces, although not fully decontrolled. Interest rates for agriculture set at seven points below general lending rate.

In social sector, most hidden indirect subsidies are converted into direct budget transfers. Plan enacted to dismantle three-tier price control system and replace it with a more streamlined system. Under reformed system, only about 20 goods and services are controlled versus 85 previously.

In reaction to CAP's stabilization policies, violent riots break out in February. More than 300 people are killed.

Export bonus scheme is extended:

A flat 30 percent export bond is applied to all exporters whose production contains a minimum 30 percent local content.

"Recadi" scandal erupts. Government accuses local and foreign companies of bribing officials to secure access to preferential rate dollars. Heads of many firms threatened with arrest.

Government initiates a three-year, $5 billion IMF agreement.

World Bank approves $755 million loan package (approximately half earmarked for trade policy reform):

Venezuela receives a $600 million bridging loan from commercial bank creditors.

At midyear, major trade liberalization program is launched:

Maximum tariffs are cut, from 130 to 80 percent. Rates to be steadily hatched down to 20 percent by 1993. Overall, reform results in 50 percent reduction in average tariff rates.
Tariff exonerations and exemptions are eliminated.
Non-tariff barriers are reduced. Import license requirements and prohibitions are cut by 70-75 percent.

Labor wins several important concessions:

Across-the-board salary increases in the private sector
A freeze on all job terminations (which was extended twice)
Establishment of a national unemployment insurance program.

1990

Phaseout of export bonus program begins.

Government publishes new investment rules which liberalize existing rules on foreign investment embodied in Decree 1200 of 1986:

Elimination of barriers to dividend and capital repatriation
Automatic approval of new foreign enterprises.

In a reverse privatization move, the state oil company PDVSA buys out the 50 percent interest in the CITGO Petroleum that it did not own.

Government begins to reorganize and decentralize many state companies to achieve greater efficiencies; some public utility services turned over to private management:

Venezuela joins the GATT
Government introduces a 10 percent value-added tax
Elimination of duties and taxes levied on imports to be used as inputs into exports
Global oil prices rise by 50 percent following outbreak of Persian Gulf crisis
Venezuela reaches agreement with commercial bank creditors on a Brady-type debt-reduction deal.

III. Analysis of the Reforms

A. Timing

- **Venezuela embarked on its economic reform program amid acute crisis conditions in the economy.** While perceptions of crisis were not necessarily widespread, foreign exchange reserves were exhausted and fiscal policy had almost completely broken down. The government had to do something. Importantly, the CAP administration did not adopt mere short-term stabilization policies, but instead embraced a hard-hitting program aimed at longer-term adjustment and structural change.

- **The program was implemented by a new presidential administration.** CAP, who had served as president from 1971 to 1977, was known, mostly trusted, and popular. In fact, he possessed strong populist credentials, having directed the nationalization of Venezuela's oil wealth in 1975. In contrast, it is improbable that the Lusinchi administration, after 1986, could have garnered the political support to push through an energetic reform program.

- **The reform program was undertaken at a time of relatively low world oil prices.** By the start of 1989, when the program was launched, world oil prices had risen to only about $17-18 per barrel, from around $13 per barrel in the oil price crash year of 1986. Oil prices fell to below $18 per barrel during the first half of 1990 (before skyrocketing to over $30 per barrel with the onset of the Persian Gulf crisis). At least privately, many Venezuelan policymakers expressed the belief that in the short run low oil prices would benefit the country by forcing changes that might not otherwise be taken.

- **Venezuela's desire to secure a debt-reduction agreement helped keep the reform program on track.** The so-called Brady Plan was a window of opportunity for Venezuela to reduce its foreign debt-overhang. Even before Mexico achieved a Brady-type debt deal, CAP announced his commitment to a similar arrangement. Venezuela's pact turned out to be even more favorable than Mexico's.

B. Sequencing

- **Major moves in key reform areas— the exchange rate, official prices and subsidies, trade and fiscal policy— were undertaken in the early months of the program.** The most critical move was

the exchange rate correction; this set the stage for subsequent price reforms and subsidy reductions. Privatization and financial market reform are two areas in which officials are expected to take more aggressive action starting in 1991.

- **Privatization has not been a central strategy of Venezuela's economic reform program.** The state oil company PDVSA has actually grown since the onset of CAP's reform. But PDVSA, unlike most other Latin American state oil companies, is extremely well managed and profitable. Due to IMF and World Bank pressure (and financial backing) for state sector reform, Venezuela is expected to more actively pursue privatization in 1991-92. Serious privatization candidates include CANTV, the state telecommunications company, and Viasa, the state-owned international airline. Meanwhile, many public sector utilities have already been reorganized to achieve greater efficiency. Some services in the power and transportation sectors are being turned over to private contractors.

- **From the start, a pro-foreign investment position has been an important element in CAP's structural reform strategy.** To some extent, CAP had to overcome doubts on the part of foreign companies regarding his real commitment to forging a role for them. Also, the Recadi scandal, although not reflective of CAP's attitude toward foreign investment, reinforced doubts about the credibility of the government's new foreign investment policy. More than anything else, CAP's reinvigoration of the debt-equity swap program was a clear, tangible sign of the government's positive regard for direct foreign investment. And the program has spurred major new foreign and mixed investments in the petrochemical and aluminum sectors, among others.

Worksheet for Venezuela

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Pre-Reform Period 1980-1988		Reform Period 1989	
				Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	80%	7.2
		Low and Uniform Tariff Barriers	6	40%	2.4	70%	4.2
		No Local Content Regulations	4	40%	1.6	60%	2.4
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	80%	7.2
		Minimal Exchange Controls	5	50%	2.5	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	70%	4.9
		Minimal Preferential Interest Rates	1	30%	0.3	50%	0.5
		Equal Access to Capital	3	70%	2.1	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	60%	4.2
		Minimal Subsidies	4	40%	1.6	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	80%	4.8
		Reduced Marginal Tax Rate	2	50%	1.0	80%	1.6
		Equitable / Uniform Tax Collection	2	50%	1.0	80%	1.6
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	40%	2.0
		Franchise Out State Services	2	30%	0.6	80%	1.6
		Simulated Privatization	3	40%	1.2	80%	2.4
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	70%	4.2
		Proactive Promotion	1	20%	0.2	50%	0.5
2	Information	Free Flow of Market Information	2	80%	1.6	80%	1.6
16	Enabling Environment	Private Property Rights	9	60%	5.4	70%	6.3
		Efficient Gov. Administration	2	30%	0.6	50%	1.0
		Legal and Accounting System	2	70%	1.4	70%	1.4
		Infrastructure	3	60%	1.8	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE UNWEIGHTED		100	43.5	42.5	68.7	70.1

VENEZUELA

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GROSS PRODUCT										
Real % Change in GDP:	-2.0	-0.3	0.7	-5.6	-1.4	0.2	6.5	3.6	5.8	-8.3
By sector: Agriculture	1.9	-1.9	3.6	0.4	0.8	8.3	8.3	4.1	4.6	--
Industrial Activity	-5.2	-2.0	-3.9	-5.3	-2.7	0.5	7.4	2.5	5.6	--
Services	-4.4	1.3	-1.1	-2.9	-0.1	1.2	6.2	3.3	6.0	--
Per Cap. GNP-Current US $	4070	4730	4920	4790	4140	3790	3560	3230	3250	--
PURCHASING POWER PARITY COMPARISON										
Income Index, US=100	38.79	35.81	33.25	29.75	27.13	25.35	26.37	25.01	23.65	22.29
Purchasing Index, US=100	78.73	86.40	90.67	93.52	70.33	68.59	78.72	82.87	90.83	95.49
EXTERNAL TRADE and BALANCE OF PAYMENTS (US bn$, unless otherwise indicated)										
Imports (cif) (1980 prices)	11.83	13.21	13.55	9.15	8.09	8.95	9.30	9.42	10.13	--
Exports (fob) (1980 prices)	19.29	18.17	16.44	15.86	17.68	17.06	18.46	17.58	19.50	--
Current Account	4.73	4.00	-4.25	4.43	4.65	3.33	-2.25	-1.39	-5.81	2.50
Capital Account	-0.97	-4.02	-3.91	-4.10	-3.02	-2.55	-2.46	0.10	-0.25	--
Changes in Reserves	-3.82	0.01	8.22	-0.89	-1.48	-1.26	3.78	0.72	4.22	-0.10
External Debt	29.31	32.09	32.09	38.20	36.79	35.24	34.55	35.20	34.66	--
Interest Payments (on foreign debt)	1.23	1.26	1.63	1.72	1.96	1.78	2.22	2.47	2.68	2.66
Export Growth %	-16.6	-5.8	-9.6	-3.5	11.5	-3.5	8.2	-4.8	10.9	--
Terms of Trade % Change	46.0	11.6	-5.8	-8.2	-1.0	-2.2	-48.5	11.5	-22.6	--

Pre-Reform Period [ ] Reform Period [ ] Estimated [ ]

VENEZUELA

OTHER KEY INDICATORS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Inflation (CPI) %	21.5	16.2	9.6	6.3	12.2	11.4	11.5	28.1	29.5	84.5
Fiscal Deficit (-)/Surplus as a % of GDP	0.04	-1.4	-4.4	-1.5	3.3	5.1	-2.0	-3.4	-7.8	1.7
Investment Share of GDP %	26.4	24.4	27.7	12.2	15.7	17.2	20.2	24.3	30.4	--
Savings Share of GDP %	33.3	29.3	25.1	20.5	27.0	26.8	20.3	25.2	24.8	--
Unemployment %	6.2	6.4	7.1	9.8	13.4	14.0	10.3	8.5	7.7	--
Real Wage Index[1] 1980=100	100.0	121.0	119.0	119.0	109.0	110.0	106.0	--	--	--
Government Share in Economy %[2]	14.9	17.9	17.7	17.8	18.6	17.6	16.5	--	--	--
Gross New Foreign Investment (US mn$)	54.7	183.9	257.0	86.0	18.0	68.0	16.0	21.0	89.0	213.0

[1]Refers to manufacturing wages only.
[2]Refers to consolidated government expenditures expressed as percentage of gross output.

Sources: International Monetary Fund - IFS.
World Bank World Tables 1989-90.
International Labor Office, Yearbook of Labor Statistics, 1986.
World Bank External Debt Tables 1986 & 1989.
Penn World Table (Mark 4), Robert Summers and Alan Weston, University of Pennsylvania.
The Economist Intelligence Unit.

Pre-Reform Period ☐ Reform Period ☐ Estimated ☐

III. COMPARATIVE STRUCTURAL REFORM MATRICES

Comparative SRM Values: Pre-Reform Period
Africa

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Algeria		Cote d-Ivoire		Ghana		Kenya		Madagascar		Nigeria		Senegal		Tanzania		Zambia	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	30%	2.7	20%	1.8	20%	1.8	20%	1.8	40%	3.6	30%	2.7	30%	2.7	30%	2.7
		Low and Uniform Tariff Barriers	6	30%	1.8	40%	2.4	20%	1.2	30%	1.8	30%	1.8	40%	2.4	50%	3.0	40%	2.4	40%	2.4
		No Local Content Regulations	4	30%	1.2	30%	1.2	40%	1.6	60%	2.4	50%	2.0	50%	2.0	30%	1.2	40%	1.6	40%	1.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	30%	2.7	30%	2.7	30%	2.7	20%	1.8	30%	2.7	10%	0.9	40%	3.6	30%	2.7
		Minimal Exchange Controls	5	20%	1.0	50%	2.5	30%	1.5	30%	1.5	30%	1.5	20%	1.0	20%	1.0	30%	1.5	30%	1.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	30%	2.1	80%	5.6	30%	2.1	40%	2.8	30%	2.1	20%	1.4	20%	1.4	20%	1.4	30%	2.1
		Minimal Preferential Interest Rates	1	20%	0.2	40%	0.4	20%	0.2	30%	0.3	30%	0.3	20%	0.2	20%	0.2	30%	0.3	30%	0.3
		Equal Access to Capital	3	20%	0.6	30%	0.9	30%	0.9	30%	0.9	20%	0.6	30%	0.9	20%	0.6	30%	0.9	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	60%	4.2	20%	1.4	30%	2.1	40%	2.8	40%	2.8	30%	2.1	20%	1.4	30%	2.1
		Minimal Subsidies	4	20%	0.8	30%	1.2	20%	0.8	30%	1.2	40%	1.6	20%	0.8	20%	0.8	20%	0.8	30%	1.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	30%	1.8	40%	2.4	30%	1.8	10%	0.6	20%	1.2	10%	0.6	40%	2.4	20%	1.2
		Reduced Marginal Tax Rate	2	20%	0.4	30%	0.6	30%	0.6	40%	0.8	40%	0.8	30%	0.6	40%	0.8	50%	1.0	40%	0.8
		Equitable / Uniform Tax Collection	2	30%	0.6	30%	0.6	20%	0.4	40%	0.8	10%	0.2	30%	0.6	10%	0.2	30%	0.6	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	30%	1.5	10%	0.5	10%	0.5	50%	2.5	10%	0.5	20%	1.0	20%	1.0	20%	1.0
		Franchise Out State Services	2	20%	0.4	50%	1.0	20%	0.4	30%	0.6	10%	0.2	20%	0.4	10%	0.2	20%	0.4	20%	0.4
		Simulated Privatization	3	60%	1.8	40%	1.2	20%	[illegible]	20%	0.6	10%	0.3	30%	0.9	20%	0.6	20%	0.6	20%	0.6
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	50%	3.0	20%	1.2	50%	3.0	10%	0.6	50%	3.0	30%	1.8	20%	1.2	40%	2.4
		Proactive Promotion	1	20%	0.2	30%	0.3	30%	0.3	50%	0.5	50%	0.5	50%	0.5	50%	0.5	30%	0.3	40%	0.4
2	Information	Free Flow of Market Information	2	20%	0.4	50%	1.0	50%	1.0	40%	0.8	50%	1.0	50%	1.0	50%	1.0	60%	1.2	40%	0.8
16	Enabling Environment	Private Property Rights	9	30%	2.7	70%	6.3	50%	4.5	60%	5.4	10%	0.9	60%	5.4	60%	5.4	40%	3.6	40%	3.6
		Efficient Gov. Administration	2	20%	0.4	50%	1.0	10%	0.2	20%	0.4	20%	0.4	20%	0.4	10%	0.2	40%	0.8	30%	0.6
		Legal and Accounting System	2	30%	0.6	70%	1.4	30%	0.6	60%	1.2	20%	0.4	50%	1.0	40%	0.8	60%	1.2	40%	0.8
		Infrastructure	3	70%	2.1	70%	2.1	20%	0.6	40%	1.2	30%	0.9	60%	1.8	40%	1.2	30%	0.9	40%	1.2
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	27.0	26.6	44.5	45.6	26.5	27.5	35.7	35.1	27.4	25.6	34.3	35.1	27.8	28.2	33.0	31.8	32.2	31.9

Comparative SRM Values: Reform Period
Africa

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Algeria		Cote d-Ivoire		Ghana		Kenya		Madagascar		Nigeria		Senegal		Tanzania		Zambia	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	40%	3.6	40%	3.6	70%	6.3	90%	8.1	50%	4.5	70%	6.3	80%	7.2	60%	5.4	50%	4.5
		Low and Uniform Tariff Barriers	6	40%	2.4	50%	3.0	70%	4.2	50%	3.0	60%	3.6	70%	4.2	70%	4.2	50%	3.0	60%	3.6
		No Local Content Regulations	4	50%	2.0	40%	1.6	50%	2.0	70%	2.8	50%	2.0	70%	2.8	40%	1.6	50%	2.0	50%	2.0
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	40%	3.6	40%	3.6	70%	6.3	80%	7.2	70%	6.3	70%	6.3	10%	0.9	70%	6.3	60%	5.4
		Minimal Exchange Controls	5	60%	3.0	60%	3.0	60%	3.0	60%	3.0	40%	2.0	70%	3.5	60%	3.0	50%	2.5	60%	3.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	80%	5.6	80%	5.6	80%	5.6	40%	2.8	60%	4.2	40%	2.8	70%	4.9	60%	4.2
		Minimal Preferential Interest Rates	1	50%	0.5	50%	0.5	90%	0.9	70%	0.7	40%	0.4	80%	0.8	30%	0.3	50%	0.5	50%	0.5
		Equal Access to Capital	3	40%	1.2	50%	1.5	80%	2.4	30%	1.5	30%	0.9	60%	1.8	30%	0.9	60%	1.8	60%	1.8
11	Prices and Wages	Limited Wage and Price Controls	7	50%	3.5	40%	2.8	80%	5.6	70%	4.9	50%	3.5	70%	4.9	80%	5.6	70%	4.9	70%	4.9
		Minimal Subsidies	4	60%	2.4	40%	1.6	80%	3.2	50%	2.0	60%	2.4	80%	3.2	70%	2.8	70%	2.8	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	30%	1.8	20%	1.2	90%	5.4	60%	3.6	20%	1.2	50%	3.0	20%	1.2	70%	4.2	40%	2.4
		Reduced Marginal Tax Rate	2	40%	0.8	50%	1.0	80%	1.6	90%	1.8	60%	1.2	60%	1.2	60%	1.2	60%	1.2	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	60%	1.2	80%	1.6	50%	1.0	20%	0.4	50%	1.0	30%	0.6	60%	1.2	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	60%	3.0	50%	2.5	30%	1.5	70%	3.5	70%	3.5	40%	2.0	30%	1.5	40%	2.0
		Franchise Out State Services	2	80%	1.6	66%	1/2	70%	1.4	70%	1.4	20%	0.4	60%	1.2	30%	0.6	40%	0.8	70%	1.4
		Simulated Privatization	3	90%	2.7	60%	1.8	70%	2.1	70%	2.1	20%	0.6	80%	2.4	30%	0.9	60%	1.8	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	40%	2.4	60%	3.6	90%	5.4	70%	4.2	80%	4.8	80%	4.8	90%	5.4	50%	3.0	60%	3.6
		Proactive Promotion	1	50%	0.5	50%	0.5	90%	0.9	70%	0.7	60%	0.6	90%	0.9	60%	0.6	70%	0.7	60%	0.6
2	Information	Free Flow of Market Information	2	40%	0.8	60%	1.2	70%	1.4	70%	1.4	50%	1.0	70%	1.4	50%	1.0	60%	1.2	60%	1.2
16	Enabling Environment	Private Property Rights	9	50%	4.5	70%	6.3	70%	6.3	70%	6.3	70%	6.3	80%	7.2	80%	7.2	60%	5.4	60%	5.4
		Efficient Gov. Administration	2	40%	0.8	50%	1.0	50%	1.0	30%	0.6	40%	0.8	40%	0.8	30%	0.6	60%	1.2	40%	0.8
		Legal and Accounting System	2	40%	0.8	70%	1.4	60%	1.2	80%	1.6	50%	1.0	70%	1.4	50%	1.0	70%	1.4	50%	1.0
		Infrastructure	3	70%	2.1	70%	2.1	50%	1.5	60%	1.8	40%	1.2	50%	1.5	40%	1.2	70%	2.1	60%	1.6
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	48.7	46.5	53.5	52.3	71.7	71.8	64.8	66.8	47.4	51.4	67.4	68.3	48.7	52.8	59.1	59.8	57.0	57.2

Comparative SRM Values: Pre-Reform Period
Asia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	India		Indonesia		Jordan		Malaysia		Philippines		South Korea		Sri Lanka		Thailand		Turkey	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	20%	1.8	30%	2.7	60%	5.4	80%	7.2	40%	3.6	30%	2.7	70%	6.3	60%	5.4	30%	2.7
		Low and Uniform Tariff Barriers	6	20%	1.2	30%	1.8	70%	4.2	80%	4.8	60%	3.6	50%	3.0	30%	1.8	60%	3.6	30%	1.8
		No Local Content Regulations	4	10%	0.4	20%	0.8	70%	2.8	60%	2.4	20%	0.8	70%	2.8	70%	2.8	60%	2.4	30%	1.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	40%	3.6	60%	5.4	80%	7.2	80%	7.2	50%	4.5	50%	4.5	70%	6.3	30%	2.7
		Minimal Exchange Controls	5	20%	1.0	50%	2.5	50%	2.5	70%	3.5	30%	1.5	40%	2.0	60%	3.0	60%	3.0	30%	1.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	40%	2.8	40%	2.8	50%	3.5	80%	5.6	40%	2.8	20%	1.4	90%	6.3	50%	3.5	30%	2.1
		Minimal Preferential Interest Rates	1	30%	0.3	30%	0.3	70%	0.7	70%	0.7	20%	0.2	10%	0.1	70%	0.7	40%	0.4	30%	0.3
		Equal Access to Capital	3	20%	0.6	30%	0.9	70%	2.1	40%	1.2	20%	0.6	20%	0.6	50%	1.5	60%	1.8	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	40%	2.8	70%	4.9	60%	4.2	90%	6.3	50%	4.2	30%	2.1	90%	6.3	80%	5.6	40%	2.8
		Minimal Subsidies	4	20%	0.8	30%	1.2	40%	1.6	70%	2.8	40%	1.6	20%	0.8	40%	1.6	60%	2.4	30%	1.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	50%	3.0	30%	1.8	20%	1.2	40%	2.4	60%	3.6	80%	4.8	30%	1.8	50%	3.0	30%	1.8
		Reduced Marginal Tax Rate	2	20%	0.4	40%	0.8	40%	0.8	50%	1.0	20%	0.4	40%	0.8	50%	1.0	60%	1.2	20%	0.4
		Equitable / Uniform Tax Collection	2	50%	1.0	30%	0.6	30%	0.6	80%	1.6	20%	0.4	40%	0.8	50%	1.0	50%	1.0	20%	0.4
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	20%	1.0	20%	1.0	30%	1.5	10%	0.5	10%	0.5	10%	0.5	70%	3.5	20%	1.0
		Franchise Out State Services	2	10%	0.2	20%	0.4	20%	0.4	40%	0.8	20%	0.4	30%	0.6	30%	0.6	60%	1.2	30%	0.6
		Simulated Privatization	3	30%	0.9	20%	0.6	20%	0.6	40%	1.2	20%	0.6	30%	0.9	20%	0.6	60%	1.8	20%	0.6
7	Foreign Investment	Non-Discriminatory Treatment	6	10%	0.6	20%	1.2	60%	3.6	30%	1.8	10%	0.6	40%	2.4	50%	3.0	80%	4.8	30%	1.8
		Proactive Promotion	1	10%	0.1	30%	0.3	60%	[illegible]	40%	0.4	50%	0.5	30%	0.3	50%	0.5	80%	0.8	20%	0.2
2	Information	Free Flow of Market Information	2	60%	1.2	30%	0.6	50%	1.0	80%	1.6	30%	0.6	30%	0.6	50%	1.0	70%	1.4	30%	0.6
16	Enabling Environment	Private Property Rights	9	50%	4.5	70%	6.3	70%	6.3	70%	6.3	70%	6.3	60%	5.4	70%	6.3	60%	5.4	50%	4.5
		Efficient Gov. Administration	2	20%	0.4	20%	0.4	60%	1.2	80%	1.5	30%	0.6	60%	1.2	40%	0.8	70%	1.4	30%	0.6
		Legal and Accounting System	2	60%	1.2	40%	0.8	70%	1.4	80%	1.6	40%	0.8	40%	0.8	80%	1.6	60%	1.2	30%	0.6
		Infrastructure	3	40%	1.2	40%	1.2	60%	1.8	70%	2.1	60%	1.8	60%	1.8	60%	1.8	40%	1.2	30%	0.9
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	28.7	28.7	33.9	37.5	51.3	52.9	63.0	65.6	37.0	43.2	38.7	40.9	52.6	55.3	61.3	62.3	29.1	31.2

Comparative SIM Values: Reform Period
Asia

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	India		Indonesia		Jordan		Malaysia		Philippines		South Korea		Sri Lanka		Thailand		Turkey	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	40%	3.6	80%	7.2	60%	5.4	80%	7.2	70%	6.3	60%	5.4	80%	7.2	60%	5.4	80%	7.2
		Low and Uniform Tariff Barriers	6	50%	3.0	80%	4.8	70%	4.2	90%	5.4	80%	4.8	70%	4.2	60%	3.6	60%	3.6	70%	4.2
		No Local Content Regulations	4	30%	1.2	70%	2.8	70%	2.8	70%	2.8	90%	3.6	80%	3.2	70%	2.8	60%	2.4	80%	3.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	80%	7.2	70%	6.3	90%	8.1	80%	7.2	80%	7.2	60%	5.4	70%	6.3	80%	7.2
		Minimal Exchange Controls	5	40%	2.0	90%	4.5	70%	3.5	80%	4.0	60%	3.0	80%	4.0	60%	3.0	70%	3.5	80%	4.0
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	60%	4.2	80%	5.6	80%	5.6	80%	5.6	70%	4.9	60%	4.2	90%	6.3	60%	4.2	80%	5.6
		Minimal Preferential Interest Rates	1	50%	0.5	80%	0.8	70%	0.7	80%	0.8	60%	0.6	90%	0.9	70%	0.7	50%	0.5	80%	0.8
		Equal Access to Capital	3	50%	1.5	80%	2.4	70%	2.1	60%	1.8	50%	1.5	70%	2.1	60%	1.8	60%	1.8	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	50%	3.5	90%	6.3	70%	4.9	90%	6.3	70%	4.9	60%	4.2	90%	6.3	80%	5.6	80%	5.6
		Minimal Subsidies	4	40%	1.6	70%	2.8	70%	2.8	70%	2.8	70%	2.8	80%	3.2	60%	2.4	60%	2.4	80%	3.2
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	40%	2.4	80%	4.8	40%	2.4	90%	5.4	50%	3.0	90%	5.4	40%	2.4	80%	4.8	50%	3.0
		Reduced Marginal Tax Rate	2	40%	0.8	90%	1.8	60%	1.2	90%	1.8	60%	1.2	60%	1.2	50%	1.0	60%	1.2	80%	1.6
		Equitable / Uniform Tax Collection	2	70%	1.4	70%	1.4	30%	0.6	80%	1.6	60%	1.2	50%	1.0	30%	0.6	60%	1.2	60%	1.2
10	Privatization	Divest Nonstrategic SOE's	5	10%	0.5	30%	1.5	30%	1.5	80%	4.0	30%	1.5	80%	4.0	50%	2.5	70%	3.5	40%	2.0
		Franchise Out State Services	2	10%	0.2	60%	1.2	30%	0.6	60%	1.2	60%	1.2	50%	1.0	50%	1.0	80%	1.6	40%	0.8
		Simulated Privatization	3	40%	1.2	50%	1.5	30%	0.9	70%	2.1	60%	1.8	70%	2.1	70%	2.1	60%	1.8	70%	2.1
7	Foreign Investment	Non-Discriminatory Treatment	6	30%	1.8	80%	4.8	70%	4.2	70%	4.2	50%	3.0	70%	4.2	70%	4.2	80%	4.8	[illegible]	4.8
		Proactive Promotion	1	50%	0.5	80%	0.8	70%	0.7	80%	0.8	70%	0.7	50%	0.5	70%	0.7	80%	0.8	90%	0.9
2	Information	Free Flow of Market Information	2	70%	1.4	50%	1.0	70%	1.4	80%	1.6	60%	1.2	60%	1.2	50%	1.0	70%	1.4	80%	1.6
16	Enabling Environment	Private Property Rights	9	60%	5.4	80%	7.2	70%	6.3	80%	7.2	70%	6.3	80%	7.2	70%	6.3	60%	5.4	70%	6.3
		Efficient Gov. Administration	2	40%	0.8	60%	1.2	60%	1.2	80%	1.6	50%	1.0	80%	1.6	60%	1.2	50%	1.0	60%	1.2
		Legal and Accounting System	2	60%	1.2	60%	1.2	70%	1.4	80%	1.6	70%	1.4	60%	1.2	80%	1.6	60%	1.2	60%	1.2
		Infrastructure	3	50%	1.5	60%	1.8	60%	1.8	70%	2.1	40%	1.2	90%	2.7	60%	1.8	50%	1.5	50%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE UNWEIGHTED		100	44.8	44.7	71.7	74.6	60.4	62.5	78.3	80.0	62.2	64.3	70.4	71.9	63.0	65.9	64.8	65.9	70.0	71.3

Comparative SEM Values: Pre-Reform Period
Central and Eastern Europe and the Soviet Union

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Czechoslovakia		Hungary		Poland		Soviet Union	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	10%	0.9	50%	4.5	30%	2.7	10%	0.9
		Low and Uniform Tariff Barriers	6	10%	0.6	40%	2.4	50%	3.0	20%	1.2
		No Local Content Regulations	4	50%	2.0	60%	2.4	60%	2.4	30%	1.2
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	20%	1.8	50%	4.5	50%	4.5	10%	0.9
		Minimal Exchange Controls	5	10%	0.5	30%	1.5	20%	1.0	10%	0.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	10%	0.7	30%	2.1	20%	1.4	10%	0.7
		Minimal Preferential Interest Rates	1	20%	0.2	40%	0.4	40%	0.4	20%	0.2
		Equal Access to Capital	3	10%	0.3	30%	0.9	20%	0.6	10%	0.3
11	Prices and Wages	Limited Wage and Price Controls	7	10%	0.7	40%	2.8	30%	2.1	10%	0.7
		Minimal Subsidies	4	20%	0.8	30%	1.2	40%	1.6	10%	0.4
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	70%	4.2	50%	3.0	30%	1.8	20%	1.2
		Reduced Marginal Tax Rate	2	50%	1.0	50%	1.0	20%	0.4	40%	0.8
		Equitable / Uniform Tax Collection	2	50%	1.0	50%	1.0	10%	0.2	10%	0.2
10	Privatization	Divest Nonstrategic SOE's	5	00%	0.0	10%	0.5	00%	0.0	00%	0.0
		Franchise Out State Services	2	10%	0.2	30%	0.6	00%	0.0	00%	0.0
		Simulated Privatization	3	30%	0.9	30%	0.9	10%	0.3	10%	0.3
7	Foreign Investment	Non-Discriminatory Treatment	6	20%	1.2	60%	3.6	10%	0.6	00%	0.0
		Proactive Promotion	1	20%	0.2	60%	0.6	20%	0.2	10%	0.1
2	Information	Free Flow of Market Information	2	10%	0.2	80%	1.6	40%	0.8	10%	0.2
16	Enabling Environment	Private Property Rights	9	20%	1.8	40%	3.6	20%	1.8	10%	0.9
		Efficient Gov. Administration	2	30%	0.6	60%	1.2	50%	1.0	10%	0.2
		Legal and Accounting System	2	40%	0.8	60%	1.2	30%	0.6	10%	0.2
		Infrastructure	3	50%	1.5	40%	1.2	30%	0.9	10%	1.5
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	24.8	22.1	44.3	42.7	27.4	28.3	13.9	12.6

Comparative SRM Values: Rel . lod
Central and Eastern Europe and the Soviet Union

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Czechoslovakia		Hungary		Poland		Soviet Union	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nonteriff Barriers	9	40%	3.6	60%	5.4	80%	7.2	30%	2.7
		Low and Uniform Tariff Barriers	6	50%	3.0	70%	4.2	80%	4.8	40%	2.4
		No Local Content Regulations	4	70%	2.8	80%	3.2	80%	3.2	40%	1.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	50%	4.5	70%	6.3	80%	7.2	40%	3.6
		Minimal Exchange Controls	5	60%	3.0	40%	2.0	60%	3.0	30%	1.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	40%	2.8	70%	4.9	30%	2.1
		Minimal Preferential Interest Rates	1	60%	0.6	50%	0.5	70%	0.7	20%	0.2
		Equal Access to Capital	3	30%	0.9	30%	0.9	70%	2.1	30%	0.9
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	60%	4.2	80%	5.6	40%	2.8
		Minimal Subsidies	4	40%	1.6	40%	1.6	80%	3.2	40%	1.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	90%	5.4	40%	2.4	90%	5.4	30%	1.8
		Reduced Marginal Tax Rate	2	50%	1.0	60%	1.2	30%	0.6	30%	0.6
		Equitable / Uniform Tax Collection	2	70%	1.4	50%	1.0	50%	1.0	30%	0.6
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	20%	1.0	30%	1.5	40%	2.0
		Franchise Out State Services	2	10%	0.2	40%	0.8	20%	0.4	30%	0.6
		Simulated Privatization	3	50%	1.5	30%	0.9	60%	1.8	40%	1.2
7	Foreign Investment	Non-Discriminatory Treatment	6	70%	4.2	60%	3.6	50%	3.0	40%	1.8
		Proactive Promotion	1	50%	0.5	70%	0.7	50%	0.5	30%	0.4
2	Information	Free Flow of Market Information	2	50%	1.0	80%	1.6	70%	1.4	40%	0.8
16	Enabling Environment	Private Property Rights	9	50%	4.5	50%	4.5	40%	3.6	40%	3.6
		Efficient Gov. Administration	2	60%	1.2	70%	1.4	70%	1.4	30%	0.6
		Legal and Accounting System	2	50%	1.0	60%	1.2	60%	1.2	20%	0.4
		Infrastructure	3	60%	1.8	40%	1.2	50%	1.5	30%	0.9
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	50.4	50.3	52.6	52.6	61.7	65.2	33.5	34.7

Comparative SRM Values: Pre-Reform Period
Latin America

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Bolivia		Chile		Colombia		Costa Rica		Jamaica		Mexico		Peru		Venezuela	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	30%	2.7	90%	8.1	40%	3.6	40%	3.6	30%	2.7	30%	2.7	60%	5.4	30%	2.7
		Low and Uniform Tariff Barriers	6	40%	2.4	80%	4.8	40%	2.4	50%	3.0	40%	2.4	40%	2.4	60%	3.6	40%	2.4
		No Local Content Regulations	4	30%	1.2	90%	3.6	50%	2.0	80%	3.2	60%	2.4	30%	1.2	50%	2.0	40%	1.6
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	30%	2.7	40%	3.6	60%	5.4	40%	3.6	60%	5.4	40%	3.6	50%	4.5	50%	4.5
		Minimal Exchange Controls	5	30%	1.5	80%	4.0	40%	2.0	50%	2.5	40%	2.0	30%	1.5	70%	3.5	50%	2.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	50%	3.5	90%	6.3	60%	4.2	70%	4.9	40%	2.8	40%	2.8	70%	4.9	30%	2.1
		Minimal Preferential Interest Rates	1	30%	0.3	90%	0.9	40%	0.4	70%	0.7	30%	0.3	30%	0.3	60%	0.6	30%	0.3
		Equal Access to Capital	3	40%	1.2	80%	2.4	30%	0.9	80%	2.4	30%	0.9	40%	1.2	60%	1.8	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	30%	2.1	50%	3.5	80%	5.6	60%	4.2	30%	2.1	40%	2.8	70%	4.9	30%	2.1
		Minimal Subsidies	4	40%	1.6	90%	3.6	50%	2.0	70%	2.8	40%	1.6	20%	0.8	70%	2.8	40%	1.6
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	20%	1.2	80%	4.8	60%	3.6	50%	3.0	30%	1.8	30%	1.8	60%	3.6	50%	3.0
		Reduced Marginal Tax Rate	2	50%	1.0	70%	1.4	50%	1.0	50%	1.0	30%	0.6	40%	0.8	50%	1.0	50%	1.0
		Equitable / Uniform Tax Collection	2	50%	1.0	90%	1.8	70%	1.4	50%	1.0	50%	1.0	30%	0.6	50%	1.0	50%	1.0
10	Privatization	Divest Nonstrategic SOE's	5	20%	1.0	70%	3.5	40%	2.0	30%	1.5	10%	0.5	10%	0.5	40%	2.0	20%	1.0
		Franchise Out State Services	2	30%	0.6	80%	1.6	50%	1.0	30%	0.6	30%	0.6	20%	0.4	40%	0.8	30%	0.6
		Simulated Privatization	3	30%	0.9	80%	2.4	30%	0.9	30%	0.9	20%	0.6	10%	0.3	60%	1.8	40%	1.2
7	Foreign Investment	Non-Discriminatory Treatment	6	50%	3.0	100%	6.0	50%	3.0	50%	3.0	30%	1.8	20%	1.2	60%	3.6	30%	1.8
		Proactive Promotion	1	40%	0.4	70%	0.7	50%	0.5	70%	0.7	20%	0.2	60%	0.6	60%	0.6	20%	0.2
2	Information	Free Flow of Market Information	2	40%	0.8	60%	1.2	70%	1.4	60%	1.2	70%	1.4	40%	0.8	70%	1.4	80%	1.6
16	Enabling Environment	Private Property Rights	9	70%	6.3	60%	5.4	60%	5.4	50%	4.5	60%	5.4	70%	6.3	70%	6.3	60%	5.4
		Efficient Gov. Administration	2	30%	0.6	90%	1.6	60%	1.2	60%	1.2	40%	0.8	50%	1.0	50%	1.0	30%	0.6
		Legal and Accounting System	2	50%	1.0	70%	1.4	70%	1.4	70%	1.4	70%	1.4	70%	1.4	60%	1.2	70%	1.4
		Infrastructure	3	40%	1.2	70%	2.1	80%	2.4	50%	1.5	40%	1.2	70%	2.1	50%	1.5	60%	1.8
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	37.8	38.2	77.0	74.9	53.5	53.7	54.8	52.4	39.1	39.9	37.4	37.1	58.5	59.8	43.5	42.5

Comparative SEM Values: Reform Period
Latin America

Category Weights	Policy Categories	Policy Options	Policy Weights "The Ideal"	Bolivia		Chile		Colombia		Costa Rica		Jamaica		Mexico		Peru		Venezuela	
				Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score	Rating	Score
19	Trade Liberalization	Low and Uniform Nontariff Barriers	9	90%	8.1	90%	8.1	50%	4.5	60%	5.4	70%	6.3	80%	7.2	20%	1.8	80%	7.2
		Low and Uniform Tariff Barriers	6	90%	5.4	90%	5.4	60%	3.6	70%	4.2	70%	4.2	90%	5.4	30%	1.8	70%	4.2
		No Local Content Regulations	4	70%	2.8	90%	3.6	60%	2.4	80%	3.2	70%	2.8	70%	2.8	30%	1.2	60%	2.4
14	Foreign Exchange Rate	Market Determined Exchange Rate	9	90%	8.1	80%	7.2	80%	7.2	80%	7.2	70%	6.3	70%	6.3	20%	1.8	80%	7.2
		Minimal Exchange Controls	5	80%	4.0	80%	4.0	60%	3.0	70%	3.5	70%	3.5	80%	4.0	10%	0.5	70%	3.5
11	Financial Market Liberalization	Market-Driven Real Interest Rates	7	90%	6.3	90%	6.3	70%	4.9	80%	5.6	60%	4.2	80%	5.6	20%	1.4	70%	4.9
		Minimal Preferential Interest Rates	1	90%	0.9	90%	0.9	50%	0.5	70%	0.7	60%	0.6	90%	0.9	30%	0.3	50%	0.5
		Equal Access to Capital	3	70%	2.1	90%	2.7	40%	1.2	80%	2.4	50%	1.5	70%	2.1	30%	0.9	70%	2.1
11	Prices and Wages	Limited Wage and Price Controls	7	90%	6.3	100%	7.0	90%	6.3	70%	4.9	70%	4.9	60%	4.2	20%	1.4	60%	4.2
		Minimal Subsidies	4	90%	3.6	90%	3.6	50%	2.0	80%	3.2	80%	3.2	80%	3.2	20%	0.8	70%	2.8
10	Fiscal and Monetary Policy	Balanced Budget / Slight Surplus	6	70%	4.2	90%	5.4	90%	5.4	80%	4.8	50%	3.0	70%	4.2	40%	2.4	80%	4.8
		Reduced Marginal Tax Rate	2	50%	1.0	90%	1.8	60%	1.2	90%	1.8	70%	1.4	80%	1.6	50%	1.0	80%	1.6
		Equitable / Uniform Tax Collection	2	70%	1.4	90%	1.8	90%	1.8	90%	1.8	70%	1.4	70%	1.4	50%	1.0	80%	1.6
10	Privatization	Divest Nonstrategic SOE's	5	40%	2.0	100%	5.0	60%	3.0	80%	4.0	80%	4.0	80%	4.0	20%	1.0	40%	2.0
		Franchise Out State Services	2	50%	1.0	80%	1.6	50%	1.0	60%	1.2	80%	1.6	60%	1.2	40%	0.8	80%	1.6
		Simulated Privatization	3	70%	2.1	90%	2.7	70%	2.1	60%	1.8	80%	2.4	70%	2.1	40%	1.2	80%	2.4
7	Foreign Investment	Non-Discriminatory Treatment	6	70%	4.2	100%	6.0	60%	3.6	60%	3.6	80%	4.8	70%	4.2	40%	2.4	70%	4.2
		Proactive Promotion	1	70%	0.7	90%	0.9	80%	0.8	90%	0.9	80%	0.8	90%	0.9	40%	0.4	50%	0.5
2	Information	Free Flow of Market Information	2	60%	1.2	90%	1.8	70%	1.4	90%	1.8	80%	1.6	60%	1.2	70%	1.4	80%	1.6
16	Enabling Environment	Private Property Rights	9	80%	7.2	80%	7.2	60%	5.4	50%	4.5	80%	7.2	80%	7.2	50%	4.5	70%	6.3
		Efficient Gov. Administration	2	50%	1.0	90%	1.8	60%	1.2	60%	1.2	60%	1.2	70%	1.4	50%	1.0	50%	1.0
		Legal and Accounting System	2	50%	1.0	80%	1.6	70%	1.4	70%	1.4	70%	1.4	70%	1.4	60%	1.2	70%	1.4
		Infrastructure	3	40%	1.2	90%	2.7	70%	2.1	70%	2.1	50%	1.5	60%	1.8	30%	0.9	70%	2.1
100	TOTAL REFORM SCORE/WEIGHTED - MEAN REFORM SCORE/UNWEIGHTED		100	70.4	75.8	89.1	89.1	65.2	66.0	73.5	71.2	69.6	69.8	73.9	74.3	35.2	31.1	68.7	70.1

IV. SOURCES

Sources for the Structural Economic Reform Survey

The Futures Group study team utilized a wide range of both published and unpublished works for background and specifics on structural economic reform progress in the 30 countries studied. Among the core sources were the following:

* The Economist Intelligence Units *Country Profile* and *Country Report* series.

* Business International's weekly reports on government policy, market regulations and business conditions. Among these were *Business Latin America, Business International* and *Business Asia*.

* The World Bank's *Trends in Developing Economies*.

* *Foreign Economic Trends and Their Implications for the United States,* published by the U.S. Department of Commerce.

* "Country Reports on Economic Policy and Trade Practices", a report submitted by the U.S. Department of State to the Committee on Foreign Relations, Committee on Finance of the U.S. Senate and the Committee on Foreign Affairs of the U.S. House of Representatives.

* Various World Bank and International Monetary Fund research and seminar papers covering particular structural reform issues or specific country experiences. Among these were the IMF *Staff Papers* and *IMF Survey* and the World Bank's country studies and Economic Development Studies series.

* For reporting and analysis of the most recent political, economic and policy events, the team relied upon reputable news sources such as *The New York Times, The Wall Street Journal, The Financial Times,* and *The Economist*. Particularly useful policy overviews were provided by the respective country surveys regularly offered by *The Financial Times* and *The Economist*.