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PUBLIC/PRIVATE TRANSITIONS: A CONCEPT PAPER

by

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Public/Private Transitions

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Executive Summary
Public/Private Transitions

1. A phase of public/private transition is underway. The public sector's role in development is under systematic review, a new emphasis is placed upon the private sector, and attempts have been launched to transfer economic resources and functions from the public to the private sphere. This broad process of change is marked by incomplete data, and considerable uncertainty and risk.

2. The search for means to reduce the burden of the public sector centers upon three categories of policy:
   - (i) direct privatization.
   - (ii) partial privatization.
   - (iii) promotion of the private sector.

3. Evaluation of the public sector burden employs, as its primary criterion, efficiency, a concept made operational through the use of quantitative indicators.

4. As part of its cooperative technical agreement with US AID, the Performance Management Project, NASPAA proposes a long-term program of applied, comparative analysis centered upon:

-- restructuring the public sector, with specific attention to:
   - (i) the fiscal burden imposed by state-owned enterprises and public bureaucracies,
   - (ii) public sector employment,
   - (iii) the reform potential of indirect privatization schemes (e.g., contracting out.)

-- long term sustainability of programs of economic reform, with specific concentration upon factors which influence the margin available to policymakers to carry reforms forward.

5. Recently, US AID has emphasized the divestiture of state-owned enterprises. NASPAA proposes not to focus directly upon divestiture per se, but rather to fill out US AID's concern with the public sector burden by addressing other significant elements of fiscal drain, namely management of public sector investment and correcting inefficiencies of sectoral ministries.

6. We regard these areas as critical to long term programs of economic liberalization and reform in developing economies. Moreover, these activities clearly fit US AID's programmatic emphasis upon policy reform and institutional development.

7. The public sector restructuring component will draw together expertise from economics, public finance and the policy sciences, in order to systematically build knowledge of:

   - (i) means to reduce fiscal drains imposed by state-owned enterprises and public bureaucracies.

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(ii) means to contain and manage public sector employment.
(iii) means to improve economic incentives and efficiency in fiscal management.
(iv) means to design and evaluate indirect privatization options, particularly investment and contracting out.

8. The program will strengthen host country institutions through:

(i) analytic and applied support to Mission policy dialogue.
(ii) improvements in the collection and organization of data.
(iii) strengthening LDC and U.S. resources for policy analysis, decision support and implementation.
(iv) installation of managerial accounting, auditing, and performance evaluation systems.
(v) use of public finance and economic management specialists to advise on specific policy strategies.

9. The "sustainability of reform" component will draw together expertise in political and policy research, with the aim of comparatively analyzing factors which influence the margin for reform decisions and implementation in specific issue areas (fiscal reform, reduction of public sector employment, contracting out.) Factors to be examined include:

(i) the international and macro-economic policy context.
(ii) domestic interest groups.
(iii) intra-bureaucratic conflict/administrative systems.
(iv) problem definition, decision and implementation management by policy-makers.

10. Guiding research in these areas is interest in:

(i) means to increase economic efficiency in selected reform efforts.
(ii) assessing how new data, policy learning and collaborative research strengthen elite commitment to reform.
(iii) assessing the usefulness of diverse risk management techniques (e.g. partial compensation, public persuasion, containment.)
(iv) understanding the influence of timing/sequencing to reform programs.

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Public/Private Transitions: A Concept Paper

I. Introduction: the LDC public sector burden.

During the postwar period, the public sector has played a lead role in development. Since the government was regarded as the logical institution to carry out various development functions -- investment in basic infrastructure, provision of services, creation of national industries, structuring the general economic environment -- the public sector in developing countries expanded rapidly. Between 1960 and 1980, there was a 'quiet revolution' among developing countries of assorted ideological types; the public sector grew at an average of 2-3% per annum, absorbing by the late 1970s between one quarter and one third of GDPs.[1]

Since the late 1970s a 'new realism' has set in. Whereas in the 1950s and 1960s interest had focused upon understanding the forms of 'market failure' for which public sector solutions were considered essential, interest more recently has shifted to understanding the manner in which state interventions in the marketplace are themselves prone to failure.[2] Without abandoning the assumption that the public sector has a positive role to play developmentally, observers now strive to understand the diverse ways in which the public sector imposes a burden upon the development of national economies.[3]

To that end, critical reevaluations have begun of (a) direct government production (state-owned enterprises) (b) areas of public sector expenditure (services, subsidies and transfers, investment, interest payments, on-lending) and (c) critical macroeconomic policies (exchange rates, pricing, regulatory practises, tax regimes.)[4]

Analysis of the public sector burden would be considerably easier if the size and composition of public sector expenditure routinely correlated with economic performance.[5] However, the aggregate scale and the distribution of public resources in most ailing developing economies, most notably in Latin America and Africa, are not significantly different from what is seen in advanced industrial countries, or for that matter, from the experience of the East Asian 'Little Tigers' who have shown such success in promoting export growth: "... the public sector in most developing countries accounts for 15-25 per cent of value added in GDP and some 50-60 percent of total investment. For industrial countries as a group, the public sector's contribution to value added is a little bit higher but its share in investment is lower."[6]

The burden operates in a more complicated fashion than simple size. One must be sensitive to the pace of expansion -- relative to the growth of the general economy -- and to the quality and effectiveness of the many policy interventions which the public sector undertakes. Over time, the burden manifests itself through the various costs which these diverse interventions generate.

Guiding the evaluation of the cost effects of the public sector is the concept of efficiency. To understand the burden requires assessing the degree to which the public sector allocates resources efficiently (e.g., via prices, intervention in markets) and the degree to which state institutions themselves demonstrate operational efficiency (e.g. via the level of competent management of ministries and development programs.) In each instance, there are 'static' and 'dynamic' dimensions involved in assessing efficiency: "In static terms, efficiency may be defined as maximizing the present value of output from a given level of inputs. Alternatively, when the goal is to achieve a particular social objective (such as malaria eradication) or to provide a specific service (for example, a telephone link), efficiency may be defined as cost minimization. Either way, a key factor determining efficiency is the pricing of inputs and outputs to reflect relative scarcities. Prices of goods that deviate significantly from their scarcity value .. may be regarded as "distorted." "[7]

Conceptually and in practice, the public sector burden is far from straightforward. Inefficiencies are created through a complex matrix of policies and institutions. Also, matters are made more complicated since (a) data essential to evaluating costs are often insufficient; (b) costs often arise from 'social goals' of public policy, functions not easily quantified; (c) cost burdens are often the result of the intricate interaction between public sector interventions and international forces.[8]

Still, it is possible to employ efficiency criteria to evaluate the public sector burden; typically, multiple measures of productivity are applied in a systematic manner.[9] A key assumption of this paper is that analytical tools do exist -- drawn from economics, public finance, the policy sciences -- which can be profitably employed to specify the source of public sector inefficiencies and prescribe remedial action. A final section of this paper outlines several specific activities which fit within such an approach.

This predominant concern with public sector efficiency does not exclude concern with issues of equity and distribution. Given that many public sector inefficiencies systematically work against the interests of the poor, public sector reform -- and the heightened efficiency it strives for -- should in many cases benefit the disadvantaged.

To illustrate the above points, and to set the stage for discussion of the policy areas upon which NASPAA could work with missions and host countries, several issues associated with public sector costs are explored in brief below.

II. Deficits, state-owned enterprises, and public employment.

In numerous cases, mismanagement of external debt has contributed to severe short term illiquidity and the threat of long term stagnation, with multiple, damaging impacts upon developing economies. Closely related to this problem is the accumulated burden created through the internal fiscal policies of the public sector. The latter include inadequate controls over financial flows, runaway employment and expenditures by public agencies, insufficient prior analysis of capital needs, inadequate maintenance of existing infrastructure, and weak mobilization of domestic fiscal resources in ways which reduce incentives.

The typical Latin American state may not absorb a flagrantly large share of GDP, yet it is responsible to a significant degree for the deteriorating monetary and fiscal crises which now threaten to overwhelm the continent's economies. The table below demonstrates the growing public debt and debt service responsibilities of select Latin American countries, highlighting the situation of several Central American states whose economic development has received special priority in US assistance programs.[10]

	External Public Debt $ millions (%GDP)		¶	Debt Service %GNP (% Export Earnings)	
	1970	1982	¶	1970	1982
Costa Rica	134 (13.8)	2,478 (111.7)	¶	2.9 (10.0)	6.2 (12.5)
Guatamala	106 (5.7)	1,119 (13.0)	¶	1.4 (7.4)	1.0 (6.6)
Honduras	90 (12.9)	1,385 (53.2)	¶	.8 (2.8)	5.7 (18.8)
Ecuador	217 (13.2)	3,912 (34.3)	¶	1.4 (9.1)	9.7 (30.8)
Peru	856 (12.6)	6,900 (33.5)	¶	2.1 (11.6)	7.4 (36.7)

Source: World Bank, World Development Report 1984, Table 16, pp.248-49.

All too often, governments have been unable to remedy this decline. On the contrary, policy mechanisms have actually accelerated that process, via the aversion to difficult structural adjustments, the absence of effective financial controls over state-owned enterprises, the tendency to seek further finance to overcome immediate shortfalls. In turn, debt has deepened and opportunities for future growth have narrowed considerably.

Admittedly, the Latin American public sector cannot be held totally responsible for this grim, unpromising state of affairs. Drawing a connection between public sector activities and associated costs is not so clean: numerous other factors join with state interventions to compound the costs borne by the domestic economy. Since the late 1970s, in particular, Latin America has been battered by rising commercial interest rates, natural calamities, deteriorating terms of international trade, and a serious decline in donor assistance and commercial bank lending. All of these points were recognized by the Kissinger Commission in 1984.

Nonetheless, it is equally undeniable that state policies and institutional interventions have contributed to the deepening of the debt burden and the profound effects which this has had upon social and economic development. In Honduras, for instance, the budget deficit has risen from $289m in 1983 to $400m in 1985, presenting an enormous drain upon the national economy. Deficits have been driven upwards not solely by declining external circumstances, but by weak coordination of macro-economic policy and by the *fiscal drains associated with public sector production activities*. The lion's share of the deficits can be traced to large government transfers to state-owned enterprises, (monies used to pay interest on domestic and foreign debt and to cover investment outlays.)

Here, a primary factor identified in explaining the balance of payments deficit is the growing fiscal burden of state-owned enterprises. "Evidence from individual countries indicates low and declining profitability. ... Low profitability limits the ability of SOEs to self-finance their investments, increasing their dependence on central government resources."[11] Yet identification of this important general dimension of the public sector burden is only the first step toward corrective action. For the applied needs of policy-makers, disaggregated data are required. At present, such data are not readily available. "Accounting deficiencies and different ways of classifying SOEs make it difficult to generalize about their financial performance or to assess the return to capital."[12] With better data, better decisions might be facilitated, and the way pointed toward improved policy implementation.

The conclusion which this discussion suggests is that genuine reform of the public sector demands analytical tools which (a) reveal with precision the way in which components of the public sector impose fiscal drains upon national economies, and which (b) identify viable strategies for containing fiscal costs. State-owned enterprises are one such component demanding systematic analysis; so too are administrative bureaucracies of the public sector. Action becomes possible when expertise in economics, public finance and the policy sciences is systematically brought to bear. How, in practice, such reform interventions can be organized is a subject explored at greater length at the end of this paper.

The above assertions warrant a note of caution. Clearly, the perspective taken here proceeds from the premise that fresh analyses and additional data are essential for public sector reform. Nonetheless, these are by no means sufficient to assure long term success. They will greatly enhance the probability of sustained reform, yet ultimate success will rest upon broader political and administrative factors influencing the margin for reform enjoyed by decision makers. For that reason, the agenda for applied study (section IV of this paper) proposes dual emphases: organized, select interventions by economists and public finance experts, combined with broad analysis of political and administrative factors by those skilled in the policy sciences.

A second dimension of the public sector burden, one closely related to recurrent deficits, is public employment. Public services, the most wage intensive area of the public sector (particularly in central administration and education,) absorb an increasing proportion of the GDP in developing countries:

Developing Countries	Public Services as % of GDP.[13]	
	1960	1980
low income	8%	11%
middle income	11%	14%

By themselves, these figures do not automatically imply a wasteful expansion of the public sector. Education, infrastructure, and other public services and investment are essential to building human skills and managing economic development. In this respect, increases in public services could signal investments of long term, productive benefit to national economies. Yet recent analyses suggest that the expansion of services results in many cases in outcomes contrary to these aims: increases in unskilled and semi-skilled labor accompanied by expansion of the public sector's wage bill (frequently already bloated.) Often, these adverse effects are associated, at best, with marginal productivity gains.

Figures from Tait and Heller's IMF survey reveal the strategic weight which public sector employees have acquired in developing economies:

Public Sector Employment (PSE)[14]

	OECD	LDCs	Africa	Asia	L.Am.
PSE share in non-ag.empl.	24%	44%	54.4%	36.0%	27.4%
PSE wages' share in natl.income	17%	16.7%	18.5%	---	15.0
Ratio: av. central govt wage to per cap. income	1.7	4.4	6.1	2.9	2.9
# PS employees per 100 inhabitants	2.4	3.1	1.9	3.1	4.6

This situation is compounded by the concentration of employment at the central government level: "The mean employment share of the central government in total general government employment in developing countries is approximately 85 percent. This figure contrasts with a ratio of only 42% in the OECD countries."[15]

Under these circumstances, predominantly urban public employees exert a disproportionate influence over budgetary (and deficit) matters, together with indirect effects upon prices, investment, and the balance of payments. Such employees are in a position to 'leverage' the number of employment opportunities upwards, and at times to raise earnings to artificially high *levels. Frequently, a dynamic begins whereby the power of entrenched public sector employees translates into ever greater earning levels and ever greater shares of the GDP, with little to show in return in terms of productivity increases. Not surprisingly, governments attempt to reduce the fiscal drain of the state by cutting recurrent operational expenses while retaining excessive employment levels. Its consequence: persistent administrative bloat combined with a decline in operational output.

This phenomenon has taken deepest roots in state-owned enterprises (which account for 14% of non-agricultural sector employment, 29% of total public sector employment, and 22% of public sector wages.)

Here again, there is an important analytical problem at play. Identification of public sector employment as an important cost imposition does not by itself facilitate effective policy action. Shortfalls in data block reform: "... it is remarkable how little information is readily accessible on public sector employment and pay in most countries.... our level of ignorance on a vitally important area of public sector policy remains astonishingly high."[16] Deficiencies extend, as well, into the realm of theory and the understanding we have of the behavior of labor markets; at present, formal economics provides little guidance in grasping the influence which different austerity reform measures, undertaken in varying national settings, have upon levels of employment and unemployment.[17]

As in the case of SOE financial flows, the resolution of the fiscal drain associated with public employment requires concentrated attention: "...it is evident that this issue of paucity of data should be dealt with systematically and remedied in the future. Considerably greater resources need to be invested... to stimulate an improvement in the statistical data base on government employment and wages."[18]

It is logical to conclude that, if these obstacles to practical reform are to be overcome, (at the same time that theoretical, economic knowledge is expanded,) a systematic strategy must be devised whereby development economists skilled in assessing the fiscal dimensions of public sector employment are enabled to undertake -- in collaboration with host country economists -- a series of applied, comparative analyses. More detail on how such a strategy could be pursued is provided later in this paper, in that section which suggests an agenda for applied study organized by NASPAA.

III. Public/private transitions.

Disenchantment with a heavily statist orientation to development is now quite pronounced. Witness the experiments begun in China and Hungary to retrench the public sector and introduce market mechanisms.[19] Moreover, due to the mounting burden of the public sector, the maturation of foreign debt, and difficult world market conditions, many developing countries confront liquidity crises which have compelled them to enter into structural adjustment agreements with the IMF and the World Bank. One consequence: these countries have committed themselves to reduce the burden of the public sector.

A phase of public/private transition has begun. Across many settings, a process of change has begun in which the public sector's role in development is under systematic review, in which a new emphasis is placed upon the private sector, and in which attempts have been launched to transfer economic resources and functions from the public to the private sphere.20

US AID itself has an important role to play here. The policy dialogue now underway between US AID and host governments, supported by the flow of US programmatic assistance, allows US AID to contribute, at the practical level, to defining those policies which advance the public/private transition.21

The search for means to reduce the burden of the public sector centers upon three interrelated categories of policy:

(a) policies associated with direct privatization. That is, efforts to cope with the fiscal burden of SOEs through divestiture, liquidation, leasing, partial sales, and shareholding schemes (including leveraged buyouts).

(b) policies aimed at partial privatization -- the reform and rehabilitation of the public sector. The primary objective is not change in formal ownership, but rather the redefinition of guidance and control mechanisms, intended to infuse commercial criteria into the operation of public bureaucracies and SOEs. Special emphasis is placed upon creating the means to monitor and control financial flows and employments levels, and upon creating market-like mechanisms (through management contracting, through contracting out, and through formal agreements between parastatal managers and central ministries which permit greater managerial autonomy and specify the 'social functions' which SOEs are to perform and the costs involved.)

(c) policies which actively encourage the private sector's contribution to economic development. Concern here is with understanding and reforming the present economic environment which private actors face. A guiding assumption is that with every private sector transaction, there are costs associated, directly or indirectly, with the public sector. These costs relate to tax, commercial and legal codes, exchange rate policy, regulatory and licensing procedures. Development of the private sector requires assessing the bearing which these factors have upon market behavior. To that end, the search is underway to understand how the public sector structures the private sector environment, and to devise reform strategies which lower the costs of conducting business and facilitate the operation of market forces.

Furthermore, in an evolving market economy the public sector has a positive, long term role to play in managing the economic environment.[22] Provision must be made for a basic legal order, for the enforcement of contracts and the continuity of exchange procedures, and for the guarantee of property rights. Increasingly, as developing countries move away from heavily statist orientations and towards greater market emphasis, there is the need to consider how these essential public sector functions -- weak and overshadowed by statist interventions in many countries -- may be systematically strengthened.[23]

Efforts to bring reform in these three ways are conditioned by several significant factors. The reduction of the public sector burden and the shift of responsibility in the direction of the private sector are each highly complex and relatively new undertakings. Policy knowledge remains incomplete. As pointed out earlier, the identification of a problem and a general policy strategy does not assure informed action. Disaggregated data (relating to financial performance, employment levels, etc...) cannot be assumed, yet it is essential in identifying at the micro-level the inefficiencies imposed by the public sector. More often than not, such data must be actively collected and organized.

So too is it prudent not to seize upon a single course of reform prematurely. Orthodox economic liberalization programs undertaken in Chile, Argentina and Uruguay, for instance, encountered serious, unforeseen difficulties which undercut the drive to expand exports and made serious mid-course revisions necessary.[24] In retrospect, it became apparent that then-existing theory was inadequate to guide selection of transition paths.[25]

Not surprisingly, there is persistent, high uncertainty regarding the benefits which individual policy reforms will bring. Leaders who strive to reduce public employment levels, for instance, often do not know the likely benefits which will result. Nor are they likely to know with great confidence what the risks will be of organized reaction to such measures. In small, poor and heavily trade dependent countries, these calculations occur under special circumstances. The likely losers in the adjustment process tend to come from the urban areas (technocrats, public employees, intellectuals, the military); hence leaders' fears of effective, organized reaction are immediate and real. In consequence, the commitment to change on the part of governments -- the sustainability of efforts to reduce the public sector burden -- remain important and under-analyzed issues.

Divestiture illustrates these points. A complex and variable undertaking, divestiture is not a policy area where there is a large accumulation of empirical knowledge (in developing countries.) Persons working in this area have recently begun to advance our knowledge and to make an organized analysis more possible; the AID International Conference on Privatization, in February, 1986, confirmed this point. It is now apparent, for instance, that it is necessary to be sensitive to (a) what the objectives are in each case (i.e. whether the primary aim is to raise public sector funds quickly through the sudden disposal of valuable assets, to enhance private sector competition, or to eliminate drains on the state fiscal system) and (b) the short and long term implications of the strategy chosen. In these respects, policy knowledge remains limited at present, yet is accumulating quickly in many areas, throwing forward a 'second generation' of issues.

Increasingly, there is an awareness that risks and uncertainties, together with other constraints, make it unlikely that divestiture will be employed widely in the developing world. Elliot Berg, in his address to the US AID International Conference on Privatization, argued convincingly that formidable difficulties peculiar to developing countries (and generally absent in the advanced industrial world) will impede divestiture. These include a limited number of buyers, a high number of SOE 'losers' of little attractive value, weak finance markets, the exclusion on political grounds of commercially-active ethnic groups (Chinese, East African Asians, Levantines), a small domestic constituency and a large coalition of opponents (labor, intellectuals, the military, technocrats).[26]

Certain objectives may be reached swiftly. It may in fact be possible to privatize select enterprises and make quick gains. But these early triumphs are likely to be the exception more than the rule. Already, there is growing recognition that greater promise lies in activities which fall into the 'partial privatization' category: leasing arrangements, contracting-out of services, deregulation (of transport, education, health, veterinary services, agricultural marketing.)

In sum, major changes will be achieved through long-term programs of sustained, incremental change. Most success is likely to result from programs which patiently but persistently (a) rehabilitate public bureaucracies and enterprises -- by identifying and containing fiscal costs, by bringing the employment situation under control, by pursuing 'partial privatization' options which enjoy a sufficient latitude for action -- and (b) which attend to the complex and evolving needs of private sector entrepreneurs.

IV. Public sector reform: an agenda for applied study

NASPAA presently provides US AID missions with a variety of services under the terms of the Performance Management Project, NASPAA's cooperative technical agreement with US AID's Bureau for Science and Technology. Under the terms of that arrangement, NASPAA proposes to work with regional bureaus and individual missions to initiate a new program of applied comparative analysis and field service. The program is to concentrate upon two dimensions of the public/private transition:

-- the restructuring of the public sector: with specific concentration upon (a) monitoring progress in the containment of the fiscal costs of SOES, and active involvement in research and action to improve efficiency of fiscal management, investment, and ministry resource use, (b) upgrading the management of public sector employment, (c) evaluating and promoting forms of indirect privatization (e.g. contracting out).

-- the long term sustainability of reform programs: with specific concentration upon factors which influence the margin available to policymakers to carry reforms forward.

These areas appear critical, over the long term, to the success or failure of efforts to liberalize developing economies.

The proposed program fits well with present policy priorities of US AID. Project activities will touch directly upon three of US AID's four programmatic components -- policy reform, institutional development, promotion of private sector development -- while they will relate indirectly to the remaining priority, that of technological transfer.[27] By design, the proposed program addresses US AID's guidelines for research. Its focus rests upon institutional performance, with the aim of simplifying and strengthening central structures of the public sector -- "building down" for the sake of promoting private sector growth and the recovery of developing economies.[28]

A. Restructuring the public sector.

This paper has argued that the fiscal and employment dimensions of the public sector burden are critical, and that forms of partial privatization offer greatest promise in terms of the public/private transition. It is proposed that the heart of this program be aimed at directly addressing these public sector deficiencies and at evaluating and promoting experiments in partial privatization.

It is expected that such applied study will be of direct utility to US AID missions, that it will generate substantial field funding, that it will produce valuable comparative data regarding the fiscal and institutional dynamics of the public sector, and that it will create important opportunities for collaborative study involving analysts from host countries.

To these ends, it is proposed that NASPAA initiate a program which draws together expertise from several related fields: economics, public finance, the policy sciences.

The project will organize analysis around the following set of applied concerns:

(a) means to reduce fiscal drains imposed by state-owned enterprises and public bureaucracies.

Increasingly, it is recognized that governments require mechanisms for the management and control of public finances, particularly fiscal matters linking central ministries with SOEs.[29] Sub-topics requiring systematic analysis include: terms of credit, levels of debt, strategies for managing accumulated debt, capital investment expenditure, internal subsidies, budgetary practices. The divestiture of state entities, a distinct and complex policy area, will be monitored but will not be the main emphasis of the program.

(b) means to better manage public sector employment.

This includes assessment of the unit costs of public services, consideration of strategies and mechanisms for lowering overall employment levels, programs to improve the retention of scarce managerial and technical talent.

(c) improved structure for mobilization and use of financial resources.[30]

Various aspects of fiscal systems to be brought under systematic review include: the structure and elasticity of tax codes, administrative effectiveness in regard to collection and enforcement. Such applied work could be of great use in countries like Guatamala, where severe drops in public revenue threaten to corrode essential infrastructures.

(d) partial privatization options.

Comparative analysis is required of the various instruments which fall into this category: contracting out, management contracting, franchising, leasing, deregulation, formal agreements between parastatal managers and central ministries.

A considerable body of empirical knowledge now exists regarding the experience in the United States with these options, particularly contracting out.[31] It is important that evaluative practices, strategies of action, and institutional designs be adapted and employed in the developing country context. Also, data from developing countries has recently begun to accumulate.[32] Equally important, US AID missions, like that in Honduras, have recognized that over the past years considerable resources have been channeled to contracting out experiments, and that it is now worthwhile to evaluate critically the experience of these efforts. NASPAA has begun organizing such a study which could prove to be a useful model for further future work in this area.

It is expected that in the four areas outlined above the project will simultaneously strengthen and streamline public sector institutions through:

(a) analytical and applied research support to Mission policy dialogue.

(b) improvements in the collection and organization of data.

(c) installation of managerial accounting, auditing, and performance evaluation systems.

(d) strengthening LDC and U.S. resources for policy analysis, decision support, and implementation.

(e) focused involvement of public finance and economic management specialists, in advising on specific policy strategies.

It will be necessary, in carrying this program forward, to assemble talent and apply lessons of experience from a variety of appropriate sources. Already, NASPAA has accumulated considerable experience through the Performance Management Project. The proposed NASPAA review of US AID's experience with contracting out in Honduras, if funded by the Mission, will add to this knowledge base. As of July 1, 1986, Professor Richard Moore of Princeton's Woodrow Wilson School will join NASPAA as a Research Associate for a period of at least two years. A Latin Americanist as well as a specialist in American urban affairs, Professor Moore will bring to NASPAA extensive experience in macro-economic policy and urban finance.

Syracuse University's work in revenue systems is an example of another important resource group. Through the Local Revenue Administration Project (LRAP), other specialists at Syracuse University have pursued an integrated package of activities organized around the analysis of fiscal systems. They have analyzed the institutional instruments available (e.g. intergovernmental grants, credit institutions), examined and begun implementation of changes in administration, training, and technology (computerization), permitting examination of the manner in which incentives are structured, and the varying strengths of competing explanatory models. In their work in Jamaica and Grenada, they have also succeeded in demonstrating the potential for establishing, as part of the policy dialogue, an enduring relationship of trust with domestic government counterparts. As a result, a consensus has arisen as to the major course of change to be undertaken and the incremental steps required to achieve final ends.

Quite clearly, the Syracuse experience could be productively applied to the new public sector reform program. The LRAP project itself has underlined the need for analysis of the sort envisioned here. In a recent summary of its major findings, the Syracuse group concluded: "One must strengthen the central government administration and control apparatus in centralized LDCs before one can strengthen the local government's ability to mobilize revenues."[33]

Finally, scattered across universities and private firms are individuals with considerable experience in evaluating and designing programs of partial privatization, particularly in the area of municipal services. E.S. Savas, Elinor Ostrom, Sheldon

Gellar, Barbara Stevens and others have critically examined the nature of public goods, developed useful taxonomic categories, and conducted extensive empirical research. Their work and related analytic methods could be profitably integrated into a program of public sector reform.

B. Analysis of the sustainability of reform.

Programs of economic liberalization and administrative reform are marked by a high frequency of failure: "...the batting average of planned stabilization programs, especially in the poorer countries, has not been good."[34]

While the economic rationale appled in steering public/private transition may be lucid and convincing, competing rationales capable of undermining reform programs are also at play:

> ... planners, policy makers, and politicians must weigh "sensible" economic and administrative reform proposals against pressing and equally "sensible" concerns about political stability, legitimacy, and support-building and about the political importance and reward systems of bureaucratic structures. In short, while donor advice focuses on "economic rationality," decision-makers in Third World countries must be equally aware of demands for "political rationality."
>
> There is ...accumulating evidence that the demands of politics and administrative systems seriously impede implementation of economic agreements.[35] (emphasis added)

Thus far, in this critical area "it is fair to say that there has been little systematic analysis..."[36] In formulating diverse reforms, donor and host country officials have had to operate without an organized or detailed understanding of how factors which significantly influence the possibilities for reform -- e.g. leadership perceptions and unity, interest group behavior, internal bureaucratic pressures -- are to be acknowledged and integrated into reform programs. In the absence of such analyses, policy makers have relied almost exclusively upon economic rationales. Failures in implementation, as noted above, have grown in number. So too has the awareness grown that a systematic program of study is imperative:

> In the case of stabilization programs, an attempt to anticipate political and administrative obstacles and to so design the program to cope with these obstacles, is no more than practical. Failure to do so, in fact, is irresponsible, both vis-a-vis the government concerned, and with respect to effective use of the resources of the external agency.

> The importance of considering political sustainability is buttressed by the high costs of failed programs. Failures are costly in terms of resources expended, and in terms of sacrifices suffered for little or no lasting gains. Failures may also create a legacy of cynicism and bitterness and seriously complicate future efforts.[37] (emphasis added)

It is proposed that NASPAA help address this deficiency by initiating research which includes those policy areas. At present, logical sites for such research are the reform of fiscal systems, experiments in contracting out and other forms of partial privatization, efforts at upgrading the management of public sector employment.

It is proposed that in these separate policy areas NASPAA direct a comparative research program -- across several countries -- which operates from within a common analytical framework (to be explained below).[38] For example, the stable of analysts at the Harvard Institute for International Development provides one possible sub-contracting group appropriate to such an undertaking. In their recent writings (from which a portion of this proposal is drawn) they elaborate a proposed course of action and demonstrate a refined sensitivity to the issues which concern us. They also include within their ranks a number of persons with extensive field experience in Latin America. Similarly, Latin Americanists like Professor Barry Ames of Washington University, trained in both contextual interpretation and in quantitative analysis of changes in budgetary allocation by sector, could also fit very productively into this proposed scheme of research.[39] It is expected that the research involve extensive collaboration with the social scientists and national research institutes of host countries.

At its broadest level, the study will aim to build knowledge of how certain factors constrain (or enlarge) the margin for reform.[40] Important variables, it is argued, can function as either constraints or as opportunities. Above all, the program's orientation is to be pragmatic; it should result in a better understanding of what combinations of variables strengthen both the commitment of leaders and their bureaucratic capacity to manage change, such that more sustainable reform programs are made possible.

In each policy area, the following categories of factors are to be investigated in order to determine the bearing they have upon the margin for reform:

(a) the international context: the terms of conditional bargaining with donors, the role of exogenous shocks, (e.g. oil price rises, decline in terms of trade, shortages in commercial and concessionary credit, variations in interest rates.)

(b) domestic interest groups: most important will be organized urban interests (technocrats, public sector employees, unions, the military, the intelligentsia.)

(c) intra-bureaucratic conflict/administrative systems: here the focus will be competition among bureaucracies for scarce resources, the formal and informal structure of central bureaucratic bodies, their operating procedures, the level of penetration by specific interests, the degree of fragmentation of responsibility.

(d) problem definition by policy-makers: owing to the extreme centralization of decision-making, assessing the perceptions of key authorities will be essential: their perceptions as to the main issues involved, the major interests affected, possible solutions, likely winners and losers.

(e) the policy legacy: the broader macro-economic context in which reforms are attempted; how fiscal and monetary policy create a broad environment with important bearings upon the possibilities for change.

Guiding research will also be a set of analytical sub-themes:

(a) It will be important to determine in what specific ways new data, 'policy learning,' and joint collaborative research strengthen the commitment of strategic elites to reform.[41]

(b) A variety of techniques have been identified as useful in managing the risks associated with stabilization reforms: partial compensation, vigorous persuasion, diversion/obfuscation, containment (demonstration of firm commitment), depoliticization measures (e.g. reducing grain subsidies through indexing, integration of such changes into the yearly budget process, allowing market forces to determine prices.)[42] Further research is required to determine which mix of techniques is most successful in the two policy areas in question.

(c) There is considerable confusion at present as to the appropriate speed and sequencing of reform measures. Some have argued the benefits of swiftly introduced programs, broad in scope, which succeed in superceding organized interest groups.[43] Others have stressed the long time horizon of adjustment and the need to recognize the benefits of slowly paced, incremental change.[44]

Thus far, few in-depth studies have been conducted of this important issue; the single notable recent example is Joan Nelson's four country study of reductions in food subsidies.[45] Focused empirical research concerned with fiscal reform and contracting out would significantly advance knowledge in this area.

(d) In Central America and elsewhere, programs of economic liberalization and administrative reform coincide with another process actively encouraged in US policy, that of re-democratization. The interplay between policy reform and a return to democratic participation remains at present ambiguous; this is an important area of inquiry to be investigated as part of the study of fiscal reform and contracting out.

Some have argued the positive, reinforcing effects of re-democratization: "On balance, political liberalization increases the possibility of implementing austerity measures without a large increase in instability, although it hardly guarantees that outcome.[46] Alternatively, these changes may provide groups which are likely to bear the burden of adjustment an effective and legitimate means to obstruct change; this may prove to be the case with the newly elected governments of Costa Rica, Honduras, and Guatamala.

1. Elliot Berg, "Overview of Privatization: Role in Economic Growth and Techniques," International Conference on Privatization, sponsored by US AID, February 17-19, 1986. See also Accelerated Development in Sub-Saharan Africa, (the 'Berg Report,') Washington: the World Bank, 1981. This rise coincided with equally impressive expansion among advanced industrial countries; total public expenditure, as a share of GDP, rose from 29.3% in 1961 to 40.9% in 1981. World Bank, World Development Report 1984, p.17.

2. See Charles Wolf, Jr. "A theory of non-market failures," The Public Interest, #55 (Spring,1979) pp.114-133; AID Policy Paper, Recurrent Costs:Problems in Lesss Developed Countries, Bureau of Program and Policy Coordination, US Agency for International Development, Washington, D.C., May, 1982.

3. Such reappraisal is by no means confined to persons of a liberal or neo-conservative outlook. Analysts on the left have also expressed great skepticism regarding excessive state investment in unproductive infrastructure and excessive external debt. See Arthur Lewin's "The Fall of Michael Manley: A Case Study of the Failure of Reform Socialism," Monthly Review, (February, 1982).

4. The World Bank's World Development Report 1983 represents perhaps the most comprehensive recent effort to survey the areas of public sector involvement and identify in general terms the institutional and policy mechanisms by which systematic inefficiencies are imposed upon developing economies. US AID's official policies in this area are outlined in Private Enterprise Development (Revised), AID Policy Paper PN-AAQ-163, Bureau for Program and Policy Coordination, Washington, D.C. 20523, March, 1985.

5. "No simple correlation exists between composition of government expenditure and per capita income." World Bank World Development Report 1983, p.48. On the questions of size and composition, see "On the Limits of the Public Economy," David R, Cameron, Department of Political Science, Yale University, paper presented at the Annual Meeting of the American Political Science Association, New York, September, 1981; Christopher Colclough, "Are African governments as unproductive as the 'Accelerated Development Report'implies?" IDS (Sussex) Bulletin, 14,1 (January,1983) pp.11-17.

6. World Bank World Development Report 1983, p.48.

7. Ibid., pp.42-43.

8. In fact, the dozens of individual donors, each with separate systems to plan, monitor, and evaluate assistance programs, themselves strain the efficiency of host governments, a factor noted by a US AID official: "It is common for Ministries of Finance to state that the burden imposed by donors prevents them from doing the most simple of analyses." Robert J. Berg, "The long-run future of donor planning, monitoring and evaluation," International Development Review (Rome), 20, ~-3 (1980) pp.72-74.

9. See David G. Davies, "The Efficiency of Public Versus Private Firms, the Case of Australia's Two Airlines," The Journal of Law and Economics, 14, 1 (1971) pp.149-165; Barbara J. Stevens, "Comparing Public- and Private-Sector Productive Efficiency: An Analysis of Eight Activities," National Productivity Review, (Autumn, 1984) pp. 395-406; An Appraisal of Highway Maintenance by Contract in Developing Countries, by Clell Harral and Enresto Henriod, the World Bank, and Peter Graziano, consultant, June, 1985. For discussion of the broad theoretical issues involved in such inquiry, see Charles E. Lindblom, Politics and Markets, NY:Basic, 1977.

10. Blueprint for Development: The Strategic Plan of the Agency for International Development, Bureau for Program and Policy Coordination, US AID, Wash., D.C., June, 1985, p.53; see also A Report to the Secretary of State, The Commission on Security and Economic Assistance, Wash.,D.C., Nov.,1983, p.41.

11. World Development Report 1983, World Bank, p.74.

12. Ibid., p.75. Reflecting upon the findings of a study of SOES in twelve developing countries, the World Bank concluded: " In an aggregate analysis it is impossible to determine the extent to which these results reflect general economic conditions or price controls and how much they are caused by a failure to minimize costs or maximize productivity."

13. Ibid., p.48. "Also known as "public consumption," public services comprise all current government spending on wages and services and goods and services (including military outlays.) Expenditure on wages and salaries to provide public services is defined as central and local governments' contribution to GDP."

14. Peter S. Heller and Alan A. Tait, Government Employment and Pay: Some International Comparisons, Occasional Paper #24, International Monetary Fund, Washington, D.C. March, 1984.

15. Ibid., p.35.

16. Peter S. Heller and Allan A. Tait, "Government employment: some international comparisons," Finance and Development, (September,1983) pp.47.

17. Henry Bienen and Mark Gersovitz, "Economic stabilization, conditionality and political stability," International Organization, 39,4 (Autumn,1985) p.739.

18. Heller and Tait, Government Employment and Pay, 1984, p.2.

19. Peter Knight, Economic Reform in Socialist Countries: The Experiences of China, Hungary. Romania and Yugoslavia, World Bank Staff Working Paper #579, Washington, D.C. 1983.

20. See John M. Cohen, Merilee S. Grindle and S. Tjip Walker, "Foreign Aid and Conditions Precedent: Political and Bureaucratic Dimensions," World Development, 13, 12 (1985) p.1213.

21. See Private Enterprise Development, US AID Policy Paper, pp.10-16; A Report to the Secretary of State, Commission on Security and Economic Assistance, Washington, D.C. 1983, p.17.

22. See, for instance, Theodore Lowi, "The Public Character of Private Markets," unpublished paper, Cornell University, 1985. US AID's official policy in this area is spelled out in AID Policy Paper, Institutional Development, Bureau of Program and Policy Coordination, U. S. Agency for International Development, Washington, D.C., March, 1983; Blueprint for Development, pp.17-19; and AID Policy Paper, Recurrent Costs: Problems in Less Developed Countries, May, 1982.

23. "It may be that individual country circumstances will require appropriate legal and regulatory institutions conducive to private enterprise. Specific projects or sub-project activities which provide assistance for studies or advisory services to review or reform legal and regulatory barriers are encouraged." Private Enterprise Development, US AID Policy Paper, p.12.

24. See World Development, special issue "Liberalization with Stabilization in the Southern Cone of Latin America," 13,8 (August,1985).

25. One economist's judgment in regard to these three Latin American cases was remarkably stark: "theory tells us virtually nothing about optimal transition paths from a distorted system to one that is more fully liberalized."Ibid., "The Reforms and Macroeconomic Adjustments: Introduction," by Michael Bruno, p.867.

26. Elliot Berg, "Overview of Privatization: Role in Economic Growth and Techniques." US AID acknowledges this dilemma: "The poor record of state enterprises has become a drain on scarce resources and a liability to economic growth. However, political pressures have slowed the dismantling of these institutions. Thus, the changing attitudes toward parastatals have been accompanied by interest in mechanisms short of sudden divestiture which might be used to correct their poor performance." Private

Enterprise Development, US AID Policy Paper, p.8.

27. Blueprint for Development, US AID, pp. 14-23.

28. Ibid., pp. 74-75. See also "Statement of Dwight A. Ink Before the Committeee on Foreign Relations," U.S. Senate, Washington, D.C., October 1, 1985.

29. David K. Leonard, John M. Cohen and Thomas C. Pinckney, "Budgeting and Financial Management in Kenya's Agricultural Ministries," Agricultural Administration, 14 (1983) pp.105-120.

30. For a discussion of US AID's policy interest in this area, see AID Policy Paper, Recurrent Costs: Problems in Less Developed Countries, May, 1982.

31. Trudi C. Miller (ed.) Public Sector Performance: A Conceptual Turning Point, Baltimore: Johns Hopkins University, 1984; E.S. Savas, Alternatives for Delivering Public Services: Toward Improved Performance, Boulder,CO: Westview Press, 1977.

32. Gabriel Roth, "Private Provision of Public Services in Developing Countries," draft manuscript, Economic Development Institute of the World Bank, Washington, D.C. 1985.

33. LRAP: Work Plan and Budget for the Period October 1985-October 1987.

34. Joan Nelson, "The Political Economy of Stabilization: Commitment, Capacity and Public Response," World Development 12, 10, (1984) p.983.

35. Cohen et al., "Foreign Aid and Conditions Precedent," pp.1211-12.

36. Joan Nelson, "The Political Economy of Stabilization," p.984.

37. Ibid., p.984.

38. This framework is a simplified version of that presented by Cohen et al. in "Foreign Aid and Conditions Precedent."

39. See, for instance, Barry Ames, "The Politics of Public Spending in Latin America," American Journal of Political Science, XXI, 1 (February, 1977), pp.149-176; "A Note on the Political Expenditure Cycle in Latin America," Policy Studies Journal (September, 1980) pp.40-47.

40. Cohen et al. employ the term 'policy space.'

41. In many recent discussions, it has been suggested that access to newly organized information will likely alter the calculus of decision-makers: "...the information available to policy-makers can increase the ability to select appropriate policy instruments and strengthen their advocacy of such measures... information may still play a positive role as it can become a tool employed by various supportive coalitions in their efforts to alter choices," Cohen et al., "Foreign Aid and Conditions Precedent," p.1217.

42. Joan M. Nelson, Short Run Public Reactions to Food Subsidy Cuts in Selected Sub-Saharan and North African Countries, final report submitted to the Office of Long-range Assessments and Research, US Department of State and the Agency for International Development, contract 1722-420142, February, 1985.

43. See Christine A. Bogdanowicz-Bindert, "Portugal, Turkey and Peru: Three Successful Stabilization Programmes Under the Auspices of the IMF," World Development, 11,1 (1983) pp.65-70.

44. " Politicians like ambiguous results when the pie is not growing. If the politicians are reformers, and especially if they are reformers who need to garner electoral or other support rather than simply determining outcomes in a centralized fashion, they often try to move incrementally and favor policies that differentiate between groups. ... Politics calls for bargaining and incremental change, at least so politicians believe; economics often argues for rapid adjustments." Bienen and Gersovitz, "Economic Stabilization, Conditionality and Political Stability," p.747.

45. Nelson, Short-Run Public Reactions to Food Subsidy Cuts.

46. Bienen and Gersovitz, "Economic stabilization, conditionality and political stability," p.736. Joan Nelson in her study of cuts in food grain subsidies also notes the association in Senegal of stable reduction in subsidies with a return under Diouf to more open political party competition.