

**PRIVATIZATION AND
DEVELOPMENT:
INSIGHTS FROM A HOLISTIC
APPROACH, WITH SPECIAL
REFERENCE TO THE CASE
OF JORDAN**

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TABLE OF CONTENTS

List of Tables.....	viii
List of Figures.....	xi
List of Maps.....	xiii
Acknowledgements.....	xiv
Abstract.....	xvi
Introduction.....	1
PART I : PRIVATIZATION AND DEVELOPMENT: THEORY AND PRACTICE.....	18
Chapter 1 : The Role of The State in Development..	19
1.1 : Introduction.....	20
1.2 : Historical Perspectives.....	21
1.3 : The High Development Theory.....	28
1.3.1: The Keynesian Revolution.....	28
1.3.2: Balanced-Growth.....	30
1.3.3: Externalities and Interdependence (Linkages).....	33
1.3.4: Terms of Trade.....	36
1.3.5: Dependency School.....	39
1.3.6: The Consequences.....	40
1.4 : The Neoclassical Counter-revolution.....	42
1.4.1: The Collective Action Theory.....	44
1.4.2: The International Trade Theory of Rent-Seeking Activities.....	49
1.4.3: The Public Choice Theory.....	53
1.4.4: Transaction Cost Theory and Institutional Change.....	56
1.5: The Counter-Counterrevolution.....	67
1.6: Conclusion.....	82
Selected References.....	85

Chapter 2 : Public Versus Private Ownership: The Economic Rationale For Privatization in Developing Countries.....	86
2.1: Introduction.....	87
2.2: The Allocative Role of the State.....	89
2.3: The Origins of Public Sector Growth.....	93
2.3.1: Nationalization.....	94
2.3.2: The Ideological and Political Factors...	96
2.3.3: The Commanding Heights of the Economy...	97
2.3.4: Industrialization and Modernization.....	99
2.3.5: Raising Revenue and the Control of Natural Resources.....	103
2.3.6: The Lack of Local Private Entrepreneurs.	104
2.3.7: Employment Generation.....	106
2.3.8: Balanced Regional Development.....	109
2.3.9: Other Objectives.....	110
2.3.10: Summary of Goals and Arguments.....	111
2.4: Evidence on Public Enterprise Performance..	113
2.5: The Theory of the Firm.....	126
2.5.1: Theoretical Background for Existence of the Firm.....	127
2.5.2: The Behavioural and Managerial Theories of the Firm.....	129
2.5.3: Markets vs. Firms.....	132
2.6: The Theory of X-Efficiency.....	134
2.7: The Economic Theory of Property Rights.....	137
2.7.1: Ownership Specialization.....	139
2.7.2: Risk Bearing.....	140
2.7.3: Transferability of Ownership.....	142
2.7.4: Elements of Critique.....	145
2.8: The Principal-Agent Theory.....	147
2.9: Conclusion.....	157
Selected References.....	161
Chapter 3 : Review of the Empirical Evidence on Privatization in Developing Countries...	162
3.1: Introduction.....	163
3.2: Efficiency Comparison.....	167

	iii
3.3: The Factors Determining Private Investment.	175
3.4: The Relationship Between Government Size and Economic Growth.....	180
3.5: The Relationship Between Public Enterprises and Budgetary Deficit.....	184
3.6: The Relationship Between Privatization and Development.....	187
3.7: The Reasons Behind Privatization.....	189
3.8: The Relationship Between Privatization and the Distribution of Gains and Looses.....	191
3.9: Conclusion.....	194
Selected References.....	197
 Chapter 4 : Privatization, Decentralization, Participation, and Development.....	 198
4.1: Introduction.....	199
4.2: The Meaning of Development: Growth vs. Human Development.....	201
4.3: Privatization, Choice, and Participation...	206
4.4: Privatization in the Context of Exit and Voice.....	213
4.5: The Concept of Decentralization.....	220
4.6: Privatization vs. Territorial Decentralization.....	223
4.6.1: The Space Factor.....	223
4.6.2: The Structure of Government.....	225
4.7: Paradigms of Decentralized Development.....	227
4.7.1: Development from Below (Bottom-Up and Periphery-Inward).....	228
4.7.2: The Strategy of Reversal.....	231
4.7.3: Development From Within.....	234
4.7.4: The Differences Between Functional and Territorial Decentralization.....	239
4.8: Decentralization in Pactice.....	246
4.9: The Effect of Privatization on Technological Choice and the Informal Sector.....	252

4.10: The Necessity of Coordinating the Efforts for Development.....	260
4.11: Conclusion.....	264
Selected References.....	268
 PART II : THE CASE OF JORDAN.....	 269
Chapter 5 : The Jordanian Economy (1952-1992).....	270
5.1: Introduction.....	271
5.2: Jordan Prior to 1952.....	274
5.3: The First Phase of Development (1952-1972).....	279
5.3.1: The Structural Change of the Economy....	279
5.3.1.1: The Agricultural Sector.....	280
5.3.1.1.1: The Share of the Agricultural Sector.....	281
5.3.1.1.2: Land Tenure and Land Reform...	285
5.3.1.2: The Industrial Sector.....	288
5.3.1.3: The Services Sector.....	290
5.3.2: The Openness of the Economy.....	291
5.3.3: The Importance of External Transfers....	293
5.3.3.1: The External Grants.....	295
5.3.3.2: Workers' Remittances.....	296
5.3.4: Economic Planning.....	301
5.3.5: Consumption vs. Productive Capacity.....	303
5.3.6: The Social Development Indicators.....	305
5.3.6.1: The Distribution of Income.....	305
5.3.6.2: Unemployment Rates.....	307
5.3.6.3: Other Social Development Indicators.	308
5.4: The Second Phase of Development (1973-1992).....	311
5.4.1: The Characteristics of Economic Sectors.	311
5.4.1.1: The Agricultural Sector.....	311
5.4.1.2: The Industrial Sector.....	324
5.4.1.3: The Services Sector.....	331
5.4.2: The Demographic Constraint.....	334
5.4.3: High Degree of Economic Openness.....	337
5.4.4: Semi-Rentier Economy.....	342
5.4.4.1: Arab Grants.....	343
5.4.4.2: Workers' Remittances.....	347
5.4.4.3: Sources of Government Budget.....	353
5.4.5: Indicative Planning.....	354
5.4.5.1: The Three-Years Plan (1973-1975)....	354
5.4.5.2: The Five-Years Plan (1976-1980)....	356

5.4.5.3: The Five-Years Plan (1980-1985).....	359
5.4.5.4: The Five-Years Plan (1986-1990).....	360
5.4.5.5: The Five-Years Plan (1993-1997).....	362
5.4.6: High Consumption vs. Small productive Capacity.....	363
5.4.7: The Debt Burden.....	367
5.4.8: The Social Development Indicators.....	369
5.4.8.1: The Distribution of Income.....	369
5.4.8.2: Unemployment Rates.....	372
5.4.8.3: Other Social Development Indicators.	375
5.4.8.4: Rising Poverty.....	378
5.5: Conclusion.....	383
Selected References.....	387
 Chapter 6 : Privatization in Jordan.....	 388
6.1: Introduction.....	389
6.2: The Role of the State.....	391
6.2.1: Government Spending.....	391
6.2.2: Government Regulations.....	402
6.2.3: Government Ownership.....	408
6.2.3.1: Notions of State-Owned Enterprises (SOEs).....	411
6.2.3.2: The Role of SOEs on the Sectoral Level.....	413
6.2.3.2.1: Pure Domination.....	413
6.2.3.2.2: Equity Sharing.....	414
6.2.3.2.3: Mixed Sectors.....	415
6.3: Objectives and Reasons for Privatization...	416
6.4: Performance of State-Owned Enterprises (SOEs).....	423
6.4.1: The Economic Performance.....	423
6.4.1.1: The General Economic Performance...	423
6.4.1.2: Case Study: Jordan Electricity Authority (JEA).....	425
6.4.2: The Financial Performance.....	428
6.4.2.1: Case Study: Jordan Electricity Authority (JEA).....	428
6.4.2.2: The General Financial Performance of SOEs.....	432
6.5: Privatization Progress to Date.....	439
6.6: Obstacles to Privatization.....	447
6.6.1: The Economic Factors.....	447
6.6.1.1: The Valuation of the Enterprise....	448
6.6.1.2: The Need for Restructuring the Enterprise.....	448

6.6.1.3: The Lack of Regulatory Capacity...	450
6.6.1.4: Inefficient Capital Market.....	453
6.6.2: The Non-economic Factors.....	459
6.7: Conclusion.....	461
Selected References.....	468
Chapter 7 : Privatization, Decentralization, Participation, and development in Jordan.....	469
7.1: Introduction.....	470
7.2: Government Objectives on Decentralization and Participation.....	471
7.3: The Design of Decentralization and Participation.....	477
7.4: Decentralization in Practice.....	478
7.5: Measuring Decentralization and Participation.....	482
7.5.1: Decentralization Indicators.....	483
7.5.2: Decentralization Ratios (1980-1984).....	484
7.5.3: Estimated Decentralization Ratios for 1988.....	489
7.5.3.1: The Methodology of Estimation.....	489
7.5.3.2: Expenditure Decentralization Ratios	490
7.5.3.3: Revenue Decentralization Ratios....	492
7.5.4: The Allocation of Projects at the Local Level and the Issue of Participation and Development.....	494
7.6: The Effect of Privatization Policies on Participation in Agriculture by Small Farmers.....	498
7.7: Dissatisfaction and the Institutional Role.	503
7.8: Democracy, Participation, and Privatization	509
7.9: The Current Thinking of Decentralization and Development.....	515
7.10: Important Factors in the Relationship Between Privatization, Decentralization, Participation, and Development.....	519
7.10.1: Reforming SOEs.....	519
7.10.2: Bureaucratic Reforms.....	524
7.10.3: The Informal Sector.....	526
7.10.4: Legal Decentralization.....	530

	vii
7.11: Conclusion.....	531
Selected Rreferences.....	537
Chapter 8: Summary of Conclusions.....	538
8.1: Conclusions of Part I.....	539
8.2: Conclusions of Part II.....	545
Bibliography.....	554

LIST OF TABLES

2.1: The Capital Intensity Ratio of State-Owned Enterprises (SOEs) in Developing Countries Regions During 1974-1977.....	100
2.2: Public Enterprises Share of GDP and Investment in Developing Countries Regions During 1976-1982.....	102
2.3: Public Sector Share in Non-agricultural Employment in Comparative Perspective.....	107
2.4: The Social Opportunity Cost of Public Enterprises Losses (1988-1990).....	124
2.5: The Differences Between X-Efficiency Theory and the Neoclassical Theory.....	135
3.1: The Number of SOEs (1986) and Cases of Privatization (1987) in the Low-income Countries.....	163
3.2: The Number of SOEs (1986) and Cases of Privatization (1987) in the Lower Middle-income Countries.....	164
3.3: The Number of SOEs (1986) and Cases of Privatization (1987) in the Upper Middle-income Countries.....	165
4.1: Alternative Approaches to Rural Development....	242
4.2: Financial Decentralization in Local Governments in Selected Countries.....	249
5.1: The Economy Openness Ratios and the Size of Trade Deficit in Jordan During 1964-1972.....	292
5.2: Official Aid to Jordan By Source (1959-1972)...	298
5.3: The Changes in the Size of GDP and GNP in Jordan Between 1952 and 1972.....	303
5.4: The Relative Structural Importance and Contribution of the Economic Sectors to the GDP in Jordan (1973-1990).....	322
5.5: The Relative Structural Importance and Contribution of the Economic Sectors to the GDP in South Korea.....	323
5.6: Economic Openness Ratios and the Size of Trade Deficit in Jordan (1973-1991).....	338

5.7: The Relative Importance of Remittances in Major Labour Exporting Countries in Comparison With Jordan.....	350
5.8: Jordan External Debt for the Period 1984-1991..	368
5.9: The Unemployment Rates in Jordan (1970-1991)...	373
5.10: The Distribution of the Population (1991) and Labour Force (1987) Between Jordan's Governorates.....	379
5.11: Real Annual Per Capita Income in Jordan for the Period (1980-1991).....	381
6.1: Jordanian Government Spending and Its Share of the GDP for the Years 1980-1992.....	392
6.2: Jordanian Government Spending By Function During the Period 1980-1991.....	395
6.3: The Origins of Tax Revenues to the Jordanian Central Government and Their Relative Importance (1980-1990).....	398
6.4: Jordanian Gross Fixed Capital Formation (Governmental and Private) and Its Relative Importance to the GDP During the Period 1980-1990.....	403
6.5: Non-financial State-Owned Enterprises in Jordan in 1987.....	411
6.6: Overall Deficit in the Jordanian Central Government Budget (1980-1990).....	419
6.7: Net Private Foreign Investment in Jordan, 1979-1989 (selected years).....	421
6.8: Performance Indicators of Jordan Electricity Authority During the Period (1987-1992).....	426
6.9: The Financial Performance of Jordan Electricity Authority for the Years (1987-1992).....	429
6.10: Jordanian Non-financial SOEs External Debt (1970-1990).....	433
6.11: The Financial Returns for the Jordan Investment Corporation (JIC) From Investment in Shareholding Companies During the Period 1989-1991.....	434
7.1: Regional Planning Units in Jordan Development Plan (1986-1990).....	479

7.2: Expenditure Decentralization Ratios in Jordan (1980-1984).....	486
7.3: Revenue Decentralization Ratios in Jordan (1980-1984).....	487
7.4: Estimated Municipal Councils Expenditure According to Jordan's Governorates for 1988....	491
7.5: Estimated Municipal Councils Revenue in Jordan According to Source of Revenue in Each Governorate for 1988.....	493
7.6: Allocation Notion of the Loans Given by Cities and Villages Development Bank to Jordan's Municipalities.....	496
7.7: Comparison Between Trends of Human Development in Jordan With those of Developing Countries...	518

LIST OF FIGURES

5.1: The Sectoral Contribution to GDP in Jordan (1952-1972).....	282
5.2: The Changes in the Production of Main Agricultural Crops Groups in Jordan (1964-1972).....	283
5.3: The Size of Population, Schooling and Employment in Jordan (1961-1972).....	286
5.4: The Sources of Jordanian Central Government Revenue (1954-1972).....	294
5.5: Grants and Workers' Remittances Trends in Jordan (1964-1972).....	297
5.6: The Relative Importance of Grants and Workers' Remittances in Jordan (1964-1972).....	300
5.7: The Sectoral Distribution of Consumption in Jordan (1959-1972).....	304
5.8: Total Consumption, Imports and Exports As Percentage of GDP in Jordan (1964-1972).....	306
5.9: The Sectoral Contribution to GDP in Jordan (1973-1991).....	313
5.10: The Changes in the Production of Main Agricultural Crops Groups in Jordan (1973-1991).....	314
5.11: The Changes in Per Capita Field Crops Production in Jordan (1964-1991).....	315
5.12: The Sectoral Distribution of Private Sector Credits in Jordan (1971-1991).....	318
5.13: The Size of Population, Schooling and Employment in Jordan (1973-1991).....	335
5.14: Grants and Workers' Remittances Trends in Jordan (1973-1991).....	345
5.15: The Relative Importance of Grants and Workers' Remittances to the Jordanian Economy (1973-1991).....	352
5.16: The Sources of Jordanian Central Government Revenue (1973-1991).....	355
5.17: Nominal GDP and GNP Trends in Jordan (1973-1991).....	357

5.18:The Inflationary Trends in Jordan (1973-1991)..	358
5.19:The Changes in GDP Real Growth Rates in Jordan (1981-1991).....	361
5.20:The Sectoral Distribution of Consumption in Jordan (1973-1991).....	364
5.21:Total Consumption, Imports and Exports as a Percentage of GDP in Jordan (1973-1991).....	366

LIST OF MAPS

Map of Jordan..... 273

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ABSTRACT

After three decades of state intervention throughout the world the 1980s and 1990s have seen a marked reversal. Instead of government control and centralized planning there has been a renewed emphasis on market-oriented strategy. Privatization constitutes one of the cornerstones of this strategy.

The relationship between privatization and development is complex because privatization transforms the institutional framework through which people usually expound, negotiate, and promote their individual and group interests.

In theory, privatization should assist in overcoming the problems of poverty and sustainable development through the "trickle down" effect. In this thesis, however, it will be argued that privatization in developing countries and in Jordan as a case study would not exclusively lead, on the grounds of efficiency, to a successful cure for the economic ills of those countries.

The thesis also developed and applied to Jordan a methodology of analyzing privatization which departs from the mainstream view. This methodology considers privatization as one part of a whole system and can be understood within the context of development only in terms of the whole system. Thus, privatization is linked as an economic, social and political phenomenon with

decentralization, participation, and development.

The thesis concluded that development may mean decentralization, which certainly means participation, but privatization will not necessarily secure participation. It depends on how it is designed and implemented. If privatization is to be sustainable and people-centred, it has to be gradual, relatively crisis-free, untroubled and unenforced, marked by the fusion of collective participation from below (e.g., grass roots) and individual participation in the market place. This will depend exclusively on the commitment of the decision makers and their vision of empowering the people.

INTRODUCTION

Definitions of Privatization

The expansion of the public sector, in both size and scope, has been a feature of post World War 2 economic development, most markedly in Europe. Moreover, during the 1960s and 1970s, this sector dominated economic activities in developing countries as well.

After three decades of state intervention throughout the world the 1980s and 1990s have seen a marked reversal. Instead of government control and centralized planning there has been a renewed emphasis on market-oriented strategy. Privatization constitutes one the cornerstones of this.

Privatization has different meanings and different definitions. As a concept it covers a wide range of possibilities, from a change in the geometry of ownership and control from the state to the private sector at one end of the spectrum and the introduction of market discipline within the context of liberalization and deregulation at the other.

Ramanadham (1989, figure 1.1, p.5) traced three groups of privatization measures. The first relates to ownership and included total denationalization (management buy-out, Co-operatives, and special shares), joint venture and liquidation. The second concerns organizational changes to holding company structures and changes within monolithic structures such as leasing, competition and restructuring. The third and final group of measures is operational and

comprises contracting-out, incentive rewards, investment criteria, pricing principles, targets, resorting to the capital market and the rationalization of government control.

Other scholars define privatization as the concept which

"covers the transfer from the public to the private sector of the ownership and/or control of productive assets, their allocation and pricing, and the entitlement to the residual profit flows generated by them" (Adam, et al., 1992, p.6).

This definition implies the complete or partial sale of state assets, leasing, and management contracting arrangements.

Prager (1992) identified five definitions of privatization; the first is the partial sale of state assets, which does not imply attenuation of state control; the second is a change in ownership and control; the third is private ownership without any constraints on entry into the industry; the fourth changes only patterns of control rather than ownership (e.g. leasing SOE), and the fifth leaves both ownership and fundamental decision-making with the state while production, in contrast with service provision, lies in private hands (e.g. management contracts and contracting). Dieter Bos (1991) defined privatization narrowly as the sale of public sector assets and excluded issues such as contracting out, debureaucratization and the promotion of competition by market forces. Domberger and Piggot (1986, p.146) argued that privatization means **"policies designed to improve the**

operating efficiency of public sector enterprises through increased exposure to competitive market forces". This does not include deregulation. De Walle (1989) on the other hand argued that the impact and implementation of liberalization (exposure to market forces) and privatization are quite different. Thus, he defined it as the "transfer of ownership and control from the public to the private sector, with particular reference to asset sales" (De Walle, 1989, p.601). This definition is similar to that of Hemming and Mansoor (1988) and also Rees (1986). Other scholars believe that privatization is the goal of SOE reform and the concept of reforming public enterprises has been used as a synonym for privatization (Galal, 1991) (Shirly, 1990) (Shirly and Nellis, 1991).

The Objectives of the Thesis

This thesis, however, will adopt two different meanings of privatization which both serve the objectives of the study. The first is privatization as the transfer of ownership and/or control (whole or partial) from the state to the private sector. This definition does not include SOE reform programmes, deregulation or liberalization policies because these necessitate neither a change in control and ownership nor a change in the source of supply for goods and services. Thus, this definition employs the term privatization as a means of divestiture. This definition is employed exclusively in chapter 2 of the thesis as a way of analyzing the economic rationale for

privatization, particularly that of economic efficiency, which is the first aim of the thesis. The second objective of the thesis is to analyze the effect of privatization on economic development within the context of decentralization. In this domain, privatization equates with functional decentralization, as opposed to territorial decentralization, and this definition is employed in chapter 4¹.

Both definitions of privatization employed by the researcher will be argued to be complementary to a wider effort by different scholars [particularly those of the Neo-classical Political Economy (NPE) or what is called the New Institutional Economics (NIE)] as well as other international organizations (e.g. World Bank and IMF) to reduce the extent of "government failure". Privatization is introduced as a means of reducing the size of the governmental apparatus and rolling back the boundaries of state responsibility. In shifting responsibility from the state to the market privatization transforms the institutional framework through which people usually expound, negotiate, and promote their individual and group interests.

¹Functional decentralization means the decentralization of functions such as the functions of production or the provision of services from the monopolistic centralized bureaucracies to the market while territorial decentralization means the decentralization of government decision making to the sub-national levels such as local governments or authorities.

The aim of this thesis is to assess the success of privatization policies in tackling the main economic problems of developing countries during the 1990s. Among the important priorities are the alleviation of poverty as well as balanced and sustainable development. There is no easy solution to the challenge of achieving economic development. Instead it requires discussion and interaction with the needs of the people in order to bring about new ideas and probabilities for economic development.

In theory, privatization should assist in the task of overcoming the problems of poverty and sustainable development. It should benefit the poor through the "trickle down" effect as private ownership and/or control brings greater economic efficiency, more innovation, improved responsiveness to consumer demands, and wider choice for individuals. The argument of maximizing profits also implies increased savings and greater investment which in their turn produce rapid growth and higher incomes, both symbols of development according to the advocates of privatization.

In this thesis, however, it will be argued that the experience of developing countries, which is derived from the empirical work conducted on the issue of privatization by different scholars, does not exclusively lead, on the grounds of efficiency, to a successful cure for the economic ills of developing countries. In this context,

privatization is analyzed within the microeconomic criteria of efficiency.

Another task of the thesis is to develop an analysis of privatization which departs from the mainstream view. The alternative approach, which is the outcome of an effort to interpret commonalities in the privatization movements of developing countries, will depend on linking privatization as an economic, social and political phenomenon with decentralization, participation, and development. Development according to this approach means human development, and the enhancement of capabilities as the ultimate objective of development rather than growth in GNP.

This thesis focuses on the impact of privatization on development with special reference to the experience of Jordan. The specific objectives of the thesis are:

- 1) to examine the effect of privatization on the role of the state in development and question whether it will necessarily imply a minimalist state.
- 2) to discover whether a change in the geometry of ownership would crucially affect enterprise performance, in the context of developing countries generally and of Jordan. If not, what are the reasons for privatization?

3) to explore the impediments to the implementation of the privatization programme in Jordan.

4) to investigate privatization and its impact on participation, decentralization and development, particularly within the context of establishing participatory development.

To achieve the specific objectives of the thesis a large number of empirical studies conducted by different scholars have been reviewed in the various chapters². However, in particular, two empirical studies have been carried out on the case of Jordan. The first attempted to evaluate the economic performance of one of Jordan's SOE, the Jordan Electricity Authority (JEA), and the second to estimate the degree of fiscal decentralization in Jordan. The empirical studies are set in the general context of the theory and practice of privatization and decentralization, and the broader experience of Jordan. Moreover, the thesis provides for the first time a complete record of the Jordanian authorities' announcements and comments on the privatization plans drawn up between 1986 and 1993.

²The large number of empirical studies was necessary because the thesis employed an institutional approach in which the analysis must be continuously monitored by reference to cases, observation, and examples.

The Methodology of the Thesis

Given the developmental orientation of the thesis it has been necessary to employ the institutional approach in studying the case of privatization in developing countries including Jordan. The main value in utilizing such an approach is its holism. It considers privatization as one part of a whole system and can be understood within the context of development only in terms of the whole system. Consequently, the thesis inquiry has been constructed in a way that accommodates the historical, social, political, and economic factors which comprise the whole system. In this way the thesis represents a departure point from the universal laws which stamp the analysis of privatization in many studies. Studying privatization in isolation can lead to the neglect of many major economic and non-economic factors that affect the indispensable dynamic required in a development study. In other words, studying privatization without considering the whole system could lead to judgements without having specified all the relevant factors.

Moreover, the main purpose of employing this methodology is its ability to explain rather than to predict specific results. This requires a continuous reference to observations and events. The holistic methodology forms an integral part of the work of this thesis.

Outline of Research

The thesis is presented in two parts. Part I consists of

four chapters. Chapter 1 is devoted to a review of the development economics literature on the role of the state in development. This is necessary when viewing privatization as an integral part of the shift in development thinking during the 1970s and 1980s.

Chapter 2 looks at the economic rationale for privatization in developing countries within the context of ownership change. In the first three sections the chapter investigates the allocative role of the state, the origins of public sector growth in developing countries, and the empirical evidence of public enterprise performance. In the four remaining sections the chapter reviews the theoretical context of privatization by analyzing the theory of the firm, the theory of X-efficiency, the economic theory of property rights, and the principal-agent theory. Chapter 3 assesses the empirical evidence for privatization in developing countries. This is rarely brought together in the literature. This review has been constructed so as to provide readers with different aspects of privatization in developing countries. The second section of chapter 3 provides an efficiency comparison between public and private enterprises, corresponding to the arguments in chapter 2. The remaining six sections cover the wider dimension of privatization. These are the factors determining private investment, the relationship between government size and economic growth, the relationship between public enterprises and budgetary deficit, the

relationship between privatization and development, the reasons behind privatization, and finally the relationship between privatization and the distribution of gains and losses.

The last chapter of this part is chapter 4. This chapter is devoted to an investigation of privatization within the context of decentralization, participation and development.

Thus, an alternative approach has been developed to imply the use of concepts such as "choice", "participation", "voice", "appropriate technology", "linkages", and "territorial decentralization or devolution". The chapter is divided into nine sections; the meaning of development, growth vs. human development; privatization, choice, and participation; privatization in the context of exit and voice; the concept of decentralization; privatization vs. territorial decentralization; paradigms of decentralized development; decentralization in practice; the effect of privatization on technological choice and the informal sector; and the necessity of coordinating efforts for development.

Part II looks at the broader experience of privatization in Jordan within the general context of part I of the thesis. This part comprises of three chapters. Chapter 5 looks at the changes in the Jordanian economy which occurred between 1952 and 1992 to provide an evaluation of the different dimensions in Jordan's economic development.

The institutional approach employed in this evaluation encompasses the economic and non-economic factors which had a significant impact on the country's route to development.

In six sections Chapter 6 investigates the issues surrounding the initiation of and the failure to implement, privatization in Jordan. The sections are the role of the state; objectives and reasons for privatization of SOEs; performance of SOEs; privatization progress to date; and finally the obstacles to privatization. Chapter 7 examines the issues of privatization, decentralization, participation, and development within the context of Jordan. The chapter explores government objectives in decentralization and participation; the design of decentralization and participation; decentralization in practice; measuring decentralization and participation; the effect of privatization policies on participation in agriculture by small farmers; dissatisfaction and the institutional role; democracy, participation, and privatization; current thinking on decentralization and development; and the important factors in the relationship between privatization, decentralization, participation and development within the Jordanian context.

The conclusions of the thesis are provided in chapter 8.

An Overview of the Conclusions

Given the economic challenges facing decision makers in developing countries and Jordan in particular it is unlikely that privatization will lead to a minimalist role for the state in economic development. What is required is a new role with an improved quality of action. Decision makers should look for long-term objectives rather than depend on policies geared to short-term goals. The role of the state then becomes strategic rather than crisis-driven.

The institutional factors which characterise the markets of developing countries and those of Jordan (e.g. the domination of large monopolies, the lack of efficient capital markets, inefficient property rights system) mean that privatization through ownership change will not necessarily mean enhanced efficiency. Alternatively, the search for SOE problems in the context of each country may provide a better understanding of the reasons behind the difficulties of SOEs, taking into account the fact that profitability does not necessarily mean economically efficient. The conclusion, therefore, is that it is not ownership but market structure and institutions that determine the success or failure of privatization. The case study of Jordan Electricity Authority shows that the economic efficiency parameters suggested positive trends even though there were losses in this SOE. Consequently the problem of financial performance lies behind factors

which are sometimes outside the direct control of the enterprise.

From the review of the empirical evidence on the issue of privatization in developing countries it is also established that the reasons behind privatization in developing countries are not based on clear-cut evidence of the superiority of private ownership, the crowding-out hypothesis, an over-extended public sector, a positive relationship between privatization and development, or large gains for the consumers. Rather privatization is a reaction to financial crisis based on the budgetary deficits resulting from the operation of such enterprises and the subsequent pressure exerted by international aid agencies such as the World Bank and the IMF. Within Jordan, however, the reasons behind the initiation of the privatization plan in 1986 were the deep economic recession after 1985, the growing budgetary deficit, the debt crisis, a desire to attract foreign investment, and a series of imitation factors.

While the factors behind the initiation of the privatization plan in Jordan were strong, they were not sufficient to induce the government to start the implementation phase. Obstacles to the privatization of SOEs in Jordan rest on economic factors (the time needed for the valuation of the enterprises, the need for restructuring the enterprises, the lack of a regulatory

capacity, and an inefficient capital market) and the non-economic factors particularly those derived from the special characteristics of the state-society relationship.

Given the experience of the top-down approach towards development in developing countries and Jordan as a case study, empowering people at the local level might be the only viable alternative for human development during the 1990s. Such development cannot be achieved by a single decision as is the case in privatization but requires commitment to an institutional building process beyond the scope and objectives of privatization. This also means that within privatization as functional decentralization there is a need for the interests of underprivileged groups to be articulated at all stages of the privatization process. Through the promotion of a more open and interactive process an environment can be created which is more conducive to improving public confidence in the state privatization programme and more favourable to its implementation. Employing the exit and voice options simultaneously will lead to far better outcomes than when employing privatization as a symbol of exit alone. The latter approach may not increase territorial decentralization nor even fiscal decentralization as the measurement of decentralization ratios in developing countries, including Jordan, reveals.

In summary, development may mean decentralization, which certainly means participation, but privatization will not

necessarily secure participation. It depends on how it is designed and implemented. If privatization is to be sustainable and people-centred, it has to be gradual, relatively crisis-free, untroubled and unenforced, marked by the fusion of collective participation from below (e.g., grass roots) and individual participation in the market place. This will depend exclusively on the commitment of the decision makers and their vision of empowering the people.

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**PART I : PRIVATIZATION
AND DEVELOPMENT: THEORY
AND PRACTICE**

Chapter 1

The Role of the State in Development

- 1.1: Introduction**
- 1.2: Historical Perspectives**
- 1.3: The High Development Theory**
- 1.4: The Neoclassical Counter-revolution**
- 1.5: The Counter-Counterrevolution**
- 1.6: Conclusion**

1.1: Introduction

Political economy has assigned the state different roles in development . Different groups of economists have given different advice on the useful functions of the state. This has varied from recommendations on maintaining law and order, justice and defence to others who have assigned greater responsibilities to the state in bringing about development¹.

During the 1980s, however, the policy of privatizing state- owned enterprises (SOEs) became part of a general effort to roll back the role of the state in development. Within this context, the question to be asked in this chapter is; how far has the change in development thinking affected the recommended role of the state in development? A survey of development theories throughout the last five decades shows the way policy makers in developing countries have been advised and even obliged to follow conflicting views on their role in development.

An associated question, which may be difficult to answer, is how far governments, particularly in developing countries, have been affected by theoretical arguments.

This chapter is organized in four parts.

The first concentrates on the role of the state from a historical perspective. This tries to answer the question of whether there is a standardized role for the state in

¹There are many definitions of the state, but the most general one defines it as "the authoritative political institution that is sovereign over a recognised territory" (Luciani, 1990, p.xviii).

development or whether the role changes from one country to another and across time.

The second part is a review of development theories from the 1940s and 1950s, or what might be called the high development theory, and their likely affect on the role of the state in development.

The third part is devoted towards reviewing the major theories of neoclassical political economy, or what may be called the new institutional economics. Finally the counter arguments to the neoclassical counter-revolution will be presented.

This literature review serves two purposes. Firstly it shows the dynamism with which the thinking about development has been changing during the last four decades so that there is now no one simple prescribed role for the state in development. Secondly, the chapter provides a basis for the discussion in the next chapter on the role of the public sector in developing countries. This will enable an assessment of privatization policies to be attempted.

1.2: Historical Perspectives

The emergence of a strong role for the state in developing countries (late late-comers) can be viewed from the perspective of economic history².

²As the chapter links the role of the state to development thinking, mainly in post-1940s, this section will not attempt to review the classical or the Marxist theory on the role of the state, though both will be referred to in the discussion devoted to the neoclassical

One of the most famous historical perspectives during the 1950s and 1960s was that of W.W.Rostow. In his theory of the stages of growth Rostow (1960) contended that development is a linear path along which all countries must travel in order to achieve modernization. The five stages are; the traditional society; the preconditions for take-off; the take-off; the drive to maturity; and the age of mass-consumption. Rostow's argument was based on the history of advanced countries which had, at various times, passed the stage of "take-off", and the developing countries now following them. As far as the role of the state is concerned, Rostow argued that government has a major role to play in development. Development was seen primarily as a matter of economic growth, particularly in providing capital and investment in social overheads. The transitional stage required increasing food production, expanding export earnings (through agriculture and/or extractive industries), and increasing investment in infrastructure. Rostow (1990) argues

"...in different ways each of these three inescapable tasks requires positive political decisions in setting where the development must compete with other political objectives. Nowhere-not even in Britain or the United States-did modern private-enterprise industrial systems emerge without substantial government action to facilitate the process"(Rostow, 1990, p.xxiv).

During this period development economists mainly concerned

political economy and that of the dependency theory. However, for further reading on the role of the state in classical theory see Evans (1991) and on Marxist theory see Lipton (1989).

themselves with eradicating the major obstacle to development, namely the lack of capital accumulation. In practice they neglected the other two dimensions of food production and exports.

Another historian, Gerschenkron (1962), criticised this five stages theory for its linearity and studied European industrialization in terms of challenge and response.

"...[T]he more delayed was the industrialization process..., the more rapid the spurt of sudden growth which was required to break through the trammels of routine and stagnation" (Gerschenkron, 1962, p.155).

Greschenkron argued that depending on a given country's degree of economic "backwardness" (although the latter is a relative term) new private institutions may emerge to speed up the pace of industrialization or development.

However, the question was: when should the state take the initiative and intervene in the economy? The answer according to Greschenkron was that, when the degree of backwardness exceeds the ability of private institutions to eliminate it, the state may take the initiative and even supply capital for nascent industries through its banking system (Ibid, p.354). In other words, a country's economic position relative to others affects the nature of state intervention, offering the necessary "prerequisites" for the take-off stage of development.

Thus, according to Gerschenkron, the English industrial revolution during the eighteenth century was not a model for that which followed in other European countries. In

Germany, Italy and Soviet Russia (the late-comers) development was different. In England it was more gradual and less capital intensive, while in the late-comers, there was a real need for larger plants and enterprises which would benefit from economies of scale as well as being more capital intensive. Thus, since capital was scarce and the entrepreneur's ability to take the initiative was weak in the late-comer countries, the state would choose to intervene, as a substitute for the market, to generate development. Hence, it would take command of the economy by allocating resources as well as by involving itself in the production process through the establishment and management of its own firms.

Bates (1988a) also referred to the English special case or what he called "exceptionalism". In comparison with the policies towards farmers in Europe, Bates argued that in England the government followed protectionist policies under the terms of the Corn Laws, through which it favoured high agricultural prices³. Such policies were exactly the opposite to those in European countries which followed England, such as France, where consumers were favoured at the expense of farmers.

Karl Polanyi (1957, p.138) attributed the birth of

³This protectionism was through a mechanism which allowed farmers to export grain when the world price was higher than the domestic price, whereas when it was lower, imports were prohibited (Bates, 1988, p.512).

economic liberalism in England to state provision of three specific legislative acts: the reform of the Poor Law (1834), which allowed a free market for labour; the Bank Act (1844), which meant money was supplied by a self adjusting mechanism; and the reform of the land laws and repeal of the Corn Law (1846), which both created a world pool of grain and foodstuffs to be traded in. He argued that the transformation from liberalism to an interventionist economic system originated from the necessity to protect society from the threat of the market.

"For if market economy was a threat to the human and natural components of the social fabric, as we insisted, what else would one expect than an urge on the part of a great variety of people to press for some sort of protection? This was what we found" (Polanyi, 1957, p.150).

Another historical perspective has come from Pereira (1993) who selected Britain, France and the United States (the first industrial countries) as references. The argument is that in the first stage of capitalism (the mercantilism period) the state intervened to support the process of primitive accumulation. According to Pereira, government's role was a success under mercantilism but the distortions created by excessive regulation and by royal monopolies became overwhelming and gave rise to the criticism made by the classical school that the state distorted development (Pereira, 1993, p.1342).

However, Pereira has argued that state intervention in the economy shows a cyclical pattern. In the expansion phase of the cycle, state intervention increases in intensity in

order to correct, through increasing state expenditure, the distortions caused by the market. The state favours the promotion of industrialization, the redistribution of income, and regulation. After this phase, which persists for several years, state intervention gives rise to distortions such as fiscal imbalances, inflation, uncompetitive international prices and the inefficient performance of state-owned enterprises (SOEs). Thereafter, state intervention will be weakened through new reform policies such as privatization and deregulation which enhance the role of the market. At the end of the reform period a new process of state intervention will begin in response to the instabilities inherent in the market system. However, these new interventionist policies will take a form different from those of the initial phase. For Pereira this cyclical pattern was also related to the political and historical cycles proposed by Hirschman (1982).

Hirschman argued that societies swing between periods of intense preoccupation with public issues designed to bring about public happiness and welfare. Such periods are characterized by highly beneficial outcomes for individuals participating in public actions with the result that beneficiaries demand more action from the state. However, when corruption and the free riders associated with public action start to accumulate, a period devoted to the pursuit of private interest begins when people start to look after their personal or private

interests. Hirschman said that

"after a long immersion in purely private concerns, the discovery of action directed to a public purpose constitutes a liberating experience" (Hirschman, 1982, p.126).

This gives rise to a new swing towards the public sphere. Thus, historically, according to Pereira and Hirschman, the role of the state in development takes a cyclical form rather than a uniform or linear role.

Another dimension is the relationship between the role of the state in development and the different philosophical backgrounds economists have prescribed to that role. Stigler (1965) argued that economists tend to propose different roles for the state in economic affairs without solid empirical evidence. Instead they tend to generalize as an expression of personal taste (Stigler, 1965, p.7). For example, he believed that Adam Smith's advocacy of private ownership and a limited role for the state was based on two positions. The first of these was Smith's belief in the ability of the individual to make the right choices within a framework of national liberty. Stigler argued, however, that Smith proposed numerous departures from natural liberty because he (Smith) believed that the participants in voluntary transactions were incompetent or unaware of the external effects of their actions. The second basis for Smith's belief was his distrust of the state. Stigler argued that this latter position was excessively dogmatic in comparison with the first because

Smith gave no evidence, such as partial interests and the wasteful allocation of resources, for this distrust (Stigler, 1965, p.3). Stigler also provided similar arguments against other classical economists, for example John Stuart Mill and Alfred Marshall. Yet, the position of Stigler towards other economists who advocated a greater role for the state in economic affairs, such as Jevons and Pigou, did not change. The lesson to be drawn from an analysis of Stigler is that any philosophy defining the role of the state should be based on evidence rather than on personal taste. This lesson is similar to that concluded by Bates:

"by focusing on the case of England, classical and Marxian theorists have based development studies on data that are profoundly misleading"
(Bates, 1988a, p.500).

To sum up, economic historians hold different views on the role of the state in development. These roles vary from country to country depending on the degree of backwardness on the one hand and time cycles on the other.

1.3: The High Development Theory

1.3.1: The Keynesian Revolution

Throughout the 1950s and 1960s development economists such as Rosenstein-Rodan, Nurkse and Kuznets shared the view that there was a significant role for the state in lifting an economy out of its backwardness. This consensus came into being in line with Keynes' general theory (1936).

Hirschman (1984a) argued that Keynes had changed the

position dominated by the classical economics of full employment being a "special case" and introduced his view of economics including substantial unemployment as the reality. He argued that

"The Keynesian step from one to two economics was crucial: the ice of monoeconomics had been broken and the idea that there might be yet another economics had instant credibility" (Hirschman, 1984a, p.6).

The Keynesian theory achieved credibility because of its applicability as a policy guide for Western governments during the interwar depression and the Marshall Plan after WW2. Such success cast doubts on the classical market-oriented arguments and gave legitimacy to the adoption of economic planning. Keynes had claimed that without state intervention it was impossible to reach a situation of equilibrium compatible with high levels of employment in an economy. In 1926 Keynes saw the nationalization of the Bank of England as a national responsibility. The bank was no longer to function with a primary regard for the profits of its shareholders (Keynes, 1926 as cited in Mulji, 1990, p.126). Keynes was concerned with the divergence between short-term benefits in the market place and the longer-term vision necessary to achieve a steady flow of investment. Mulji argued that "if Keynesian ideas have been revolutionary in the 1930s, they were surely conventional wisdom by the 1950s" (1990, p.128). Thus, Keynes advocated an interventionist state that could secure long-term benefits for society.

1.3.2: Balanced-Growth

During the 1940s development economics arose as a distinct field in the study of economics, beginning with the work of Rosenstein-Rodan (1943) entitled "Problems of Industrialisation of Eastern and South-Eastern Europe". Rosenstein-Rodan emphasised the role of the state in achieving capital formation and balanced growth. Planned industrialisation through investment in large units would provide training for labour and introduce complementarities, both unprofitable investments for private entrepreneurs. Moreover, he argued that a backward economic structure, in particular the narrowness of domestic markets, does not offer sufficient incentives for investors to choose the right pace or pattern of capital accumulation.

Thus, there is a particular need for one type of physical capital, "social overhead capital" i.e.; railways, roads, canals and hydro-electric power stations. Segments of the economy characterized by indivisibilities and economies of scale must be created before private investors can decide on their productive investment. The argument of Rosenstein-Rodan rests on the objective of surmounting indivisibilities in both demand and supply and the emergence of external economies. The use of "social overhead capital" helps to remove indivisibilities on the supply side. Bottlenecks on the demand side, imposed by the problem of market size can be removed if a number of industries can be set up simultaneously (a big-push) using

the advantages of economies of large scale. In other words Rosenstein-Rodan characterized the entire growth phenomenon as generalized external economies, a characterization borrowed from Allyn Yong (1928) who concluded that dynamic externalities arising from investment can lead to increased output and more sophisticated capital equipment as well as move the economic system from equilibrium (as cited in Taylor and Arida, 1988, p.166).

Another lesson to be drawn from Rosenstein-Rodan's work is the role of expectation and its effect on investment by other firms. Thus, the role of the state is to reduce the uncertainty surrounding investment decisions.

Nurkse (1953) also shared the view that capital is the key to development through his theory of the vicious circle of poverty or the low-level equilibrium trap. Nurkse argued that poor countries remain poor because of their low level of per capita income which cannot supply sufficient savings to increase capital accumulation and this make increased output possible. He argued that, as external economies are important for LDCs, several sectors need to expand together within the context of balanced-growth.

However, although the Rosenstein-Rodan idea of a "big-push" is not identical with the Nurkse concept of "balanced-growth", Bliss argued that "balanced growth plus economies of scale equals the big push" (Bliss, 1989, p.1193).

Syrquin (1988) commented on the preceding approaches to development (Rosenstein-Rodan, Nurkse as well as Lewis's development model of the dual economy (1954) with an unlimited supply of Labour) that all three shared certain views concerning the functioning of LDCs economies; "labour surplus in agriculture, low mobility of factors, price inelastic demands, export pessimism, and a general distrust of the market" (Syrquin, 1988, p.213). Lewis's model was unique, however, in that it re-established the classical mechanism of reinvested profits from capitalists who save.

In general, the role of the state in development was closely linked with that of promoting industrialization, the key factor in achieving development. The central identity between planned saving and planned investment fitted well with the view of capital formation in the Harrod-Domar growth model. As a consequence, planning was necessary in order to ensure the appropriate levels of saving and capital required to achieve the targeted rate of growth.

There were two aspects of the structure of developing countries which suggested an important role for foreign aid in assisting them to enhance industrialization. These were respectively the domestic saving constraint and the foreign exchange constraint. Chenery and Bruno (1962) developed the "two-gap" model which emphasised the

limitations on policy choice in developing countries. The effect of such constraints led international aid agencies such as the World Bank to initiate a new policy in aiding developing countries (Adler, 1972). This required planned investment by the governments of developing countries as a justification of their need for aid programmes.

In a more recent contribution to this literature Taylor (1993) developed a "three-gap" model in which he added the fiscal limitation factor [i.e., public sector borrowing requirement (PSBR)] as a further constraint on the economy. In this model he focused on the role of public capital formation in crowding-in private investment. He argues that the "state and/or foreign assistance are required to get new industrial activities underway" in developing countries (Taylor, 1993, p.577). Historically, he argued, the high-tech industries in developing countries were either publicly owned or supported and were never the product of the private sector alone. Thus, there is an important role for the state in encouraging investment in the private sector.

1.3.3: Externalities and Interdependence (Linkages)

Scitovsky (1954) in his article "Two concepts of external economies" rigorously analyzed Rosenstein-Rodan's concept of external economy. He argued that external economies arise only when interdependence among the members of the economy is direct; in other words, not mediated through market transactions. He realized the need in a backward

economy for centralized investment planning because "pecuniary external economies", which arise from interdependence between firms, denoted a serious problem if guided by a pricing system as a signalling device⁴.

Thus, market prices are only useful for coordinating current production decisions. Investment allocation on the other hand requires state intervention.

Moreover, the role of the state as investment planner means that the state should "get the price right" in the sense of reflecting the correct opportunity costs and benefits (Little and Mirrlees, 1974). The essence of this literature, particularly on the key shadow prices of investment, foreign exchange and labour, has become the cornerstone for planning, particularly in the evaluation of state investment in developing countries.

Another advocate of state intervention was Hirschman (1958) who introduced the strategy of "unbalanced growth"

⁴The technological externalities, in which the action of one individual or firm directly affects the utility or profit of another, are different from pecuniary external economies which arise because of the interdependence among producers through the market mechanism or prices. Scitovsky gave the example that,

"investment in an industry leads to an expansion of its capacity and may thus lower the prices of its products and raise the prices of the factors used by it. The lowering of product prices benefits the users of these products; the raising of factor prices benefits the suppliers of the factors. When these benefits accrue to firms, in the form of profits, they are pecuniary external economies" (Scitovsky, 1954, p.147).

as well as a new concept of forward and backward linkages⁵. Hirschman criticised the "balanced growth" doctrine and argued that it was impossible for an underdeveloped economy to invest on all fronts simultaneously. Instead, he suggested that development could be seen as a "chain of disequilibria". Thus, his proposal for accelerating development was to channel investment towards projects and industries which possess strong linkage effects. The logic behind the balanced growth strategy was the insufficiency of entrepreneurial motivation on the one hand, and the need to economize on their abilities on the other. The implication of this strategy was clear advice to LDC governments to invest in large firms so as to benefit from economies of scale and to invest in projects with strong linkages. As a result, government efforts were concentrated on the industrial sector which led to adverse effects on the agricultural sector. This belief in industrial sector superiority may derived from the following quotation from Hirschman.

"... agriculture certainly stands convicted on the count of its lack of direct stimulus to the setting up of new activities through linkage effects: the superiority of manufacturing in this respect is crushing" (Hirschman, 1958, pp.109-110).

Thus, the development of LDCs was related to efforts to adopt an industrialization policy producing mostly for domestic markets. So the state's role in creating a wider

⁵Forward linkage means, utilizing the output of the project as an input for other activities in the economy, while backward linkage means, the opportunities created for other activities to supply the project with inputs.

industrial base was an inevitable condition for achieving growth. This vision of industrial development was also backed by another theoretical version of the international economy.

1.3.4: Terms of Trade

The contribution of another two economists, Singer (1950) and Prebisch (1959), provided further justification for a more interventionist state role in development, particularly in adopting import substitution industrialization (ISI) on the one hand and protectionist policies on the other.

In comparison with the previous economists, Singer and Prebisch contributions were more associated with developing countries⁶.

In Singer's contribution the distribution of gains between investing and borrowing countries was the key. He found that the historical trend of international prices for the primary goods in which LDCs possessed a comparative advantage tended to decline over time. This has imposed significant losses on the LDCs.

⁶The significance of Prebisch's contribution can be seen as being among the first theoretical contributions from a developing country itself (Argentina). In other words, the motivation behind his study was to promote modernization and industrialization objectives in LDCs in general, and in the Latin American region in particular.

"It is a matter of historical fact that ever since the seventies the trend of prices has been heavily against sellers of food and raw materials and in favour of the sellers of manufactured articles" (Singer, 1950, p.477).

Singer's conclusion was that foreign investment in developing countries should be directed towards changing the structure of comparative advantages and comparative endowments rather than developing an international trade system based on the existing one. Thus, there is a need for a complementary domestic investment which utilizes domestic resources.

Moreover, the same line of thinking appeared in a contribution by Prebisch (1959), who was chairman of ECLA (Economic Commission for Latin America), an international organization created by the United Nations. Prebisch argued that development in the LDCs, and in Latin America in particular, might face a real threat if it followed the recommendations suggested by trade theory. His argument can be summarized as follows.

Static comparative advantage as revealed by trade theory depends on current prices for goods and cannot capture secular trends. Prebisch argued that there are differences in the income elasticity of demand for imports and exports between the developed (centre) and developing countries (periphery).

"It is a well-established fact that the income elasticity of demand for imports in Latin America primary commodities by the center is generally lower than the income elasticity of demand for Latin America imports of industrial products from these centers" (Prebish, 1959, p.252).

In other words, most peripheral countries must export an increased amount of primary goods each year in order to be able to continue importing the same amount of industrial goods.

Prebish's solution to this problem was for the state to intervene and play a key role in securing development in LDCs.

His first recommendation was the adoption of import substitution policies for industrialization.

"...[W]hen demand for imports tends to grow at a faster rate than exports, import substitution is necessary to correct this disparity, and then imports constitute a declining proportion of total demand for industrial goods" (Prebish, 1959, p.254).

The second recommendation was that the state should intervene to counteract the tendency towards terms of trade deterioration which would lead to future foreign exchange shortages. For this different protection devices are required.

"...the cost of spontaneous industrialization-by the unrestricted play of market forces through exchange depreciation- ... could be reduced or avoided by protection, subsidies, an export tax, or other forms of interference"(Ibid, p.257).

The Prebish-Singer effect on development policies and the role of the state in development has been immense. The movement in LDCs toward protectionism and (ISI) policies

in the international economy can be seen in part as a reflection of this line of thought.

In summary, it appears that development theorists during the 1940s and 1950s have contributed significantly to expanding the role of the state in development. Economists realized the need for huge investment in LDCs in order to benefit from economies of scale and linkages benefits. They admitted in their analysis that market and price signals cannot guide important investment nor provide the resources which are needed. State intervention was required for direct investment through SOEs and to induce private investors through protectionist policies, which were some times based on the infant industries argument and, at other times, on the terms of trade argument⁷.

These theoretical viewpoints supported ISI policies while simultaneously discouraging attempts to adopt an export-oriented strategy.

1.3.5: Dependency School

The inward development strategy was further supported by the neo-Marxist school⁸ (Baran, Sweezy, Magdoff) and the dependency school (Frank, Cardoso and Amin) which

⁷The infant industry argument was the main growth-related argument for protection and it was first introduced by John Stuart Mill. For further analysis review (Meier and Steel, 1989, pp.252-253).

⁸For further analysis of this school review Todaro (1989, pp.100-107).

emphasised that the international economic relations between the centre and periphery nations were the major factor in the "development of underdevelopment". The conclusion of the school was "that in LDCs only the state can mobilize the surplus in a way conducive to the country's development" (Todaro, 1989, p.103). Such a conclusion contradicted their view of the state. The state according to dependency theory is an agent of international, metropolitan capital interests which extract surpluses from the developing and transfer them to the developed nations. In continuing the path of dependency, developing countries will lose their endogenous technology because of an imposed technological package transferred from the centre, which kills the local one. This results in a widening of the technological gap as well as increased dependency (Street and James, 1982, p.680). These views were developing in the era of political independence in LDCs.

1.3.6: The Consequences

As the number of newly independent developing countries rose during the 1950s and 1960s, economic independence called for the rejection of the international division of labour as instituted under the colonial administrations. Industrialization as the major objective of development found popular support among the peoples of the developing countries, who were in the era of building their national identities through "self-reliance". Within this context

the Soviet model of development had a major influence.

Thus, the role of the state became parallel with increased state intervention through direct investment in SOEs, planning, regulation, protectionism and credit policies through special development banks. This kind of state intervention ran contrary to the theories of the mainstream classical and neoclassical economists who had dominated economic philosophy before the 1930s. However, it clearly reflected acceptance of the dominant theoretical development philosophies at the time. These diagnosed the problem of backwardness but with the assumption of an unlimited capacity for the state. In other words, the theories implied that the state could intervene to correct the march toward development without incurring any problems. Bardhan noted that;

"In this literature the state was often left floating in some behavioral and organizational vacuum, making it easy to be used for a blanket endorsement of indiscriminate state intervention, the adverse effects of which for both economic growth and income distribution are now painfully obvious in many countries"
(Bardhan, 1990, pp.3-4).

As a result, during the 1970s and 1980s, the role of the state came under attack from the neoclassical political economy or what was called the New Institutional Economics (NIE) school.

1.4: The Neoclassical Counter-revolution⁹

During this period the emphasis of the neoclassical counter-revolution in development policy was on the solution of three main problems claimed to impede development. Firstly, the problem of an over-extended public sector; secondly, the problem of an over-emphasis on physical capital formation, and finally the proliferation of distorting economic controls (Toye, 1987, pp.48-49). The pioneer of this counter-revolution was Bauer (1972, 1984) (ibid, p.54).

Bauer (1984, p.6) attacked all forms of state investment. The first form is when the state intervenes in order to raise saving and investment and the second is when it intervenes because of lack of entrepreneurship. He argued that the requirement for entrepreneurship cannot justify state ownership because, if a society lacks entrepreneurs, there is no source from which the state sector can acquire them. Two objectives constitute the essence of the neoclassical counter-revolution. The first is pricism (to get the price right) through laissez-faire policies and the second is statism (reduce the scope of state intervention to a minimal requirement). The current literature merges the two, that is, free market with minimum state intervention.

Among the first studies to focus on "getting prices right", was the comparative study by Little, Scitovsky and

⁹This phrase was used by Toye (1987), Todaro (1989) and Krugman (1993).

Scott (1970) of industry and trade in some developing countries. The study attributed the poor economic performance of developing countries to the protectionist policies of ISI. The distortions in prices (overvalued exchange rates, wages, import prices) created by highly protectionist policies need to be relaxed. The authors of the study concluded that governments

"Should act more directly on prices, through subsidies and taxes, and should also encourage industry indirectly in other ways. A policy of restricting imports, through protective tariffs rather than controls, would involve greater use of the price mechanism and decentralization" (Little, et al., 1970, p.22).

They also advocated outward-oriented policies directed towards exports. They said;

"We believe that developing countries would benefit from adopting, in general, a more decentralized approach with greater use of the price mechanism; and, in particular, given that there are good prospects for exports, a more open approach to foreign trade with less protection and use of controls" (ibid, p.21).

Thus, the emphasis of the current literature on the role of the state in development has shifted towards attacking the development theories of the 1940s, 1950s and 1960s as well as introducing, in a new style, the argument of the failure of government and the need for a minimalist role for the state¹⁰. Development policies have swung towards

¹⁰This new style is what is called neoclassical political economy or the new institutional economics. The "new" is different from the "traditional neoclassical" school in four aspects. The first is that government in the NIE is at least partially endogenous and its policies are analogous to vested interests. Secondly, the invisible hand does not work in the NIE because individuals and groups use the political arena to secure or maintain rents. Thirdly, the NIE challenges the traditional

laissez-fair policies as the solution to the problems of developing countries. This argument implies in itself a minimal role for the state. There are four major schools of thought which constitute the backbone of the Neoclassical Political Economy (NPE) or what may be called the New Institutional Economics (NIE)¹¹.

1.4.1: The Collective Action Theory

The first school of thought in the NIE concerns collective action and the elimination of "the free-rider problem"¹². The incentive to free-ride was analyzed by Olson (1965). He observed that, even when groups of individuals have some common interest and as a result expect to organize a lobby for that interest, rational individuals will not act

neoclassical theory assumption of a stable perfectly competitive equilibrium because this means institutions will be passive in the analysis. Finally, the NIE believes that pareto optimality will not be freely chosen by most societies because the incentive to achieve perfect equilibrium is often small and the potential rent from cartelization is large. However, both "new" and "traditional" believe in individual rationality and the assumption of utility maximizing behaviour (Colander, 1984, pp.2-3).

¹¹The old institutionalists criticized the neo-classical school for its individualism and abstract models. For reading in the old institutionalist literature and its differences from other schools of thought see Kapp (1976), Wilber and Harrison (1978), Street and James (1982), Mayhew (1987), Radzicki (1988), Tilman (1990), Harvey and Katovich (1992).

¹²The "free rider" problem arises from two features inherent in public goods. The first is nonexcludability as once goods are provided, individuals can no longer be excluded from their benefits. The second feature is nonexhaustion, as their value to existing beneficiaries is not reduced by increasing the number of beneficiaries.

in their group interest. The reason is that the cost of lobbying for one individual will exceed the benefits he may obtain. As a result each individual will try to be a free-rider, in the sense of benefiting without any contribution to the group.

It follows that the "logic" behind the services of associations such as labour unions, professional associations, farm organizations, cartels, lobbies and even collusive groups without formal organization will be similar to the case of the government providing public goods. But the logic of such an explanation implies the demise of such groups, "unless individuals support them for some reason other than the collective goods they provide" (Olson, 1982, p.20).

In practice governments exist because they possess a monopoly over taxation. The existence of large associations or organizations will depend on their ability to provide "selective incentives" rather than on the collective goods they provide¹³.

Olson argues that small groups can engage in collective action without selective incentives because their small size enables them to provide feasible benefits for the group members even when the fruits of individual efforts are shared by the entire group.

Although there are many implications from the above logic,

¹³Olson said that a selective incentive "is one that applies selectively to the individuals depending on whether they do or do not contribute to the provision of the collective good" (Olson, 1982, p.21).

the most important is "distributional coalitions" which "are oriented to struggles over the distribution of income and wealth rather than to the production of additional output" (ibid, p.44)¹⁴. As a result those distributional coalitions or special interest groups will tend to reduce efficiency and growth wherever they operate.

In relation to the state, such special interest groups will increase their technical efficiency by gaining access to the state through their direct collective action. The consequences will be an influence on state policies through special legislation and regulations directed towards the benefit of those groups rather than towards the benefit of society. Thus, the role of the state and the complexity of its regulations will increase.

Despite many criticisms the theory of collective action has explained the reasons behind the dysfunctional role of government, particularly through the latter's regulations and protection of special interest groups¹⁵. However, it does not lead to the conclusion that the laissez-faire option is a solution to the problem of government failure.

Bates (1988b) argued that markets will not solve the interest groups problem because the latter are the dominant force in the market. In the case of Africa Bates showed how government intervention in the market place has

¹⁴For a more detailed analysis of the implications, review Olson (1982, pp.36-74).

¹⁵For a review of the criticism of the theory see Quiggin (1992) and Rogowski (1988).

favoured the small minorities of rich farmers and urban consumers. In this way the government has become an agent of private interest because small farmers are weak and cannot voice their demands because of their large number and little incentive for cooperation and what may be called the "encompassing organization effect". Furthermore Bates argued that the current policies of market orientation advised by international agencies such as the IMF and the World Bank have given politicians more influence over public policy. This is consistent with the government objective of retaining power (Bates, 1988b, pp. 351-358). A similar conclusion was reached by Nafziger (1990) in his review of three studies concerning the role of the state in the development of African countries¹⁶. He said that "regime survival in a politically fragile system requires marshalling elite support at the expense of economic growth" (Nafziger, 1990, p.150).

Another important implication of the theory is the pattern of policy bias and relative influence across the time horizon (O'Donnell, 1988) (De-Janvry and Sadoulet, 1989). As development proceeds and massive urbanization takes place, the industrial sector becomes larger which leads to more influence by new emerging interest groups in the

¹⁶The studies are;

Speder, J. and Smith, S., The Development of Capitalism in Africa (London and New York: Methuen, 1986).

Lubeck, P.M. (ed.), The African Bourgeoisie: capitalist development in Nigeria, Kenya, and the Ivory Coast (Boulder, Colorado: Lynne Rienner Publishers, 1987).

Kennedy, P., African Capitalism: the struggle for ascendancy (Cambridge: Cambridge University Press, 1988).

agricultural sector, particularly those of rich and exporting farmers. This is because the incentive for the large number of industrial workers to take collective action is reduced as their number increases while the emphasis on agriculture to supply food for the urban population and the emphasis on increasing agricultural exports will allow the emergence of a new interest group in the agriculture sector composed, mainly, of capitalist and exporting farmers.

Further implications for the theory of collective action can be linked with Hirschman's (1970) theory of exit, voice and loyalty. Hirschman defined voice "as any attempt at all to change, rather than to escape from, an objectionable state of affairs" (Hirschman, 1970, p.30). However, one of the main factors affecting the activation of voice is loyalty. Thus, as loyalty is related more to smaller groups than to larger ones, distributional interest groups will try to voice their demands rather than to use the "exit" option. This can explain why poor or larger groups such as small farmers often use the exit option by emigrating from rural areas to cities. However, Hirschman (1993) observed that "enlarging the opportunity for exit can on occasion make for more rather than less participation and voice" (Hirschman, 1993, p.177). That, when it exists represents a collective action on its own. The demonstration prior to the demise of the German Democratic Republic came, as Hirschman argues, as a result of the large number of people who escaped the German

Democratic Republic to Federal Germany before the events of 1989.

On the other hand, homogeneity of origin and the high cost of exit for squatter communities can also explain their strong collective action against opposing groups such as the state and its instruments, the military and police, when they are threatened with eviction from the state or community-owned land (Hirschman, 1984b).

The theory of collective action is also essential in the analysis of other neoclassical political economy theories. One of its main links is with the international trade theory of rent-seeking.

1.4.2: The International Trade Theory of Rent-Seeking Activities

In traditional trade strategies the division was between the structuralist school, which advocated the use of protectionist policies, and the specialization school, which favoured the use of comparative advantage in an open trade system. However, the motive for the state in introducing protectionist policies was not under investigation. Rather, more importance was given to the negative impact of tariffs and import restrictions on resource allocation and choice of technology¹⁷.

¹⁷Magee (1984) classified the theories dealing with the reasons for the existence of tariffs into three. The first group represents the policy theories, where tariffs exist to achieve policy goals (i.e., infant industry protection, industry output or employment maintenance, or government revenue). The second group comprises the terms-of-trade theories, where tariffs exist as a tool of

The concept of rent-seeking is defined as the expenditure of scarce resources to establish, acquire, or maintain a government -granted monopoly or government-granted monopoly power (Buchanan, 1980) (Posner, 1980)(Tollison, 1982). In other words, the government in this context is seen as an arena of competing interest groups which work to implement protectionist policies in favour of their own interests, and whose power base is further strengthened by protectionist policy measures. Krueger (1974) developed a model showing that import regimes with quantitative restrictions enhance lobbying activities which generate rents through the allocation of import licenses. She observed that rent-seeking activities took the form of bribery, corruption, smuggling and black markets. The cost of rent-seeking is calculated by estimating the premium on commodities sold on the black market and the premium on import licenses. Her estimate of the cost of rent-seeking was 7.3 percent of GNP in India during 1964 and 15 percent of GNP in Turkey in 1968¹⁸. Krueger's conclusion was that the social costs of tariffs are less than the costs resulting from quantitative restrictions. Another model, in which revenue seekers will compete to secure a share in the disbursement and/or transfer of tariff revenue

international redistribution (they permit a country to increase its welfare at the expense of others). The third group, which is the section's focus, is the political theories, which look to the domestic political consideration of introducing them (Magee, 1984, p.41).

¹⁸For a review to the empirical estimates of the cost of rent-seeking see Ampofo-Tuffuor, et al. (1991).

resulting in the imposition of a tariff due to collective lobbies action, was introduced by Bhagwati and Srinivasan (1980).

In another contribution to this literature, Bhagwati (1982), Bhagwati, Brecher and Srinivasan (1984), Srinivasan (1985) introduced what they called Directly Unproductive, Profit-seeking activities (DUP). The concept of DUP activities is defined as activities which

"yield pecuniary returns but do not produce goods and services that enter the utility function directly or indirectly via increased production or availability to the economy of goods that enter a utility function" (Bhagwati, 1982, p.989).

The international trade approach includes all DUP activities such as monopoly-seeking, tariff-seeking, and revenue-seeking (Colander, 1984, p.8). Thus, tariff-seeking lobbying, tariff evasion, and premium seeking for a given number of import licenses are all examples of DUP activities which, although providing profits for those who engage in them, do not increase the output of the economy but rather reduce the total production possibilities of the economy. Thus, they become a negative-sum game rather than a zero-sum game of import restrictions¹⁹.

Within this context poor economic performance becomes a

¹⁹The term Negative-Sum game was used by Tullock (1980). He observed that while the cost of organizing foreign exchange regulations was 7.3 percent and 15 percent in India and Turkey respectively, according to Krueger (1974), the costs would be higher if the waste of resources used in securing government jobs (i.e., in organizing foreign exchange) are added. He anticipated that the costs may be ten times that calculated by Krueger. Thus, it will be a negative-sum game (Tullock, 1980, p.24).

result of the institutional imperfections caused by government policies which impede the functioning of the free market.

The conclusion of this theory is that the role of the state should be minimized in order to close the door for DUP seekers, and that competition in the market will ensure the dissipation of rents²⁰.

The other conclusion of the this literature is that inward-oriented development strategies are likely to lead to more resource wastage through DUP activities; an outward-oriented strategy, therefore, will be the best alternative for developing countries to follow (Srinivasan, 1985, pp.53-58).

The main evidence this literature relies on to support its validity is the success story of the dynamic export-oriented policies of the East Asian countries (World Bank, 1987) (Balassa, 1988).

In sum, the international trade and development school introduced the concept of rent-seeking within the context of collective action in order to emphasise the cost of an interventionist state on the one hand and the deficiency of ISI policies on the other. In its final analysis, the school advocates a minimum role for the state in development and an export-oriented strategy.

²⁰For further reading in the literature of rent-seeking review Blomqvist and Mohammad (1986), Jr.Gifford (1987), Anam (1988) and Ampofo-Tuffuor (1991).

1.4.3: The Public Choice Theory

Another theory which is closely connected to the trade school above is the public choice theory which lies at the heart of the neoclassical political economy.

This theory has applied the tools and methods of neoclassical mainstream economics to the study of politics. As Buchanan and Tollison (1982) wrote;

"Public choice theory essentially takes the tools and methods of approach that have been developed to quite sophisticated analytical levels in economic theory and applies these tools and methods to the political and governmental sector, to politics, to the public economy" (Buchanan and Tollison, 1982, p.14).

Thus, Public choice theory shares with neoclassical mainstream economics the behavioral assumption that man is a rational, utility maximizer.

In other words, the theory rests on the assumption that rational individuals act in their own self interest both in the market and the non-market place.

As welfare economics does not make any behavioural assumptions about the behaviour of bureaucrats and politicians, Buchanan (1972) extended the assumption of rationality and utility maximizing individuals to the non-market or political scene. Thus, he argued that government failure should be taken more into account than the traditional emphasis on "market failure".

"...the post-Pigovian should not be allowed to generate excitement and ultimately to modify social policy by his alleged discoveries of "market failure" without, and at same time, acknowledging the comparable "failures" of his proposed political-governmental correctives" (Buchanan, 1972, p.22).

On the basis of the rationality assumption there would be no reason to assume that government or state intervention would generate improvements in the efficiency of the market. But rather they generate rent seeking activities. The statement above is derived from Buchanan's (1987) definition of politics and politicians:

"Politics is a structure of complex exchange among individuals, a structure within which persons seek to secure collectively their own privately defined objectives that cannot be efficiently secured through simple market exchanges"(Buchanan, 1987, p.1434).

Within the above context individuals will use the state as a means of taking these collective actions. Buchanan and Tullock (1962) said that,

"Collective action is viewed as the action of individuals when they choose to accomplish purposes collectively rather than individually, and the government is seen as nothing more than the set processes, the machine, which allows such collective action to take place. This approach makes the state into something that is constructed by men, an artifact"(Buchanan and Tullock, 1962, p.13).

The question is what is the social cost of government intervention in the voluntary exchange of the market? Buchanan confined the social loss associated with a distorted government policy to rent seeking activities on three levels.

If an individual or groups are faced with the prospect of differentially favourably or unfavourable government action (i.e., tax treatment) they may waste resources through first; engaging in lobbying efforts; second, engaging directly in politics to secure access to decision making power; and/or third making plans to shift into or

out of the affected activity (Buchanan, 1980, p.14). Consequently, political intervention will create disorder and depress efficiency below the social optimum. In other words, free market transactions are the only way to produce maximum efficiency and equal the social optimum. That is to say, free market competition leads to the dissipation of rents.

"If, however, governmental action moves significantly beyond the limits defined by the minimal or protective state, if government commences, as it has done on a sweeping scale, to interfere piecemeal in the market adjustment process, the tendency toward the erosion or dissipation of rents is countered and may be wholly blocked" (ibid, p.9).

The role of the state in the economy, therefore, should be minimized to one of protection only; namely the protection of individual rights, persons and property, and the enforcement of voluntarily-entered private contracts. In Buchanan's (1986) words the reason is that,

"Predation or invasion of rights, whether actual or potential, give rise to appeals to the protective capacity of the state, or, with uncertainty in rights definition, to potential litigation" (Buchanan, 1986, p.92).

The public choice theory in its observation of the role of the state does not believe in its three oft-quoted functions and reasons: "Social objectives", "national goals", and the "social welfare function" (ibid, p.87). It follows that the role of the state in "distributional justice" does not exist because, in the words of Buchanan (1986):

"There is distribution of rights, endowments, and claims among persons, along with historically determined rules that dictate limits on exchanges in such rights. The distribution is an existential reality. It is that which exists; there is, and could be, no other" (Buchanan, 1986, p.271).

As a result the state will only provide equal opportunity through its protective role. The question, which remains unanswered in this theory, is whether such a role can be provided for by a passive or minimalist state, particularly in the context of developing countries?

Another aspect which does not enter into the analysis of this school is that of transaction costs and their role in institutional change. However, these factors form the framework of the next theory.

1.4.4: Transaction Cost Theory and Institutional Change

There was no place for transaction costs in the analysis of the previous two theories (trade and public choice).

This theory thus differs from the previous two through its questioning of causes and origins of state intervention in the market place or economic affairs in general. The main assumption is that institutions are transaction-cost minimizing arrangements which may alter and evolve over time as a result of changes in the nature and sources of transaction costs (North, 1989).

Transaction costs²¹ have three main dimensions, one of

²¹There are many definitions of transaction costs but the general one is the costs which are involved in contracting. These are the direct costs (information,

which is concerned with their role in economic organization. The main contributor to this literature is Williamson (1975, 1979, 1981, 1985) who has combined the concepts of bounded rationality and opportunistic behaviour²². In this dimension, transaction cost analysis provides an analytical framework for explaining contractual choices²³. This dimension is also related to the literature of incomplete information, Stiglitz (1988, 1993), and to the "agency problem" (Jensen and Meckling, 1976) (Sappington, 1991) (Carlos, 1991). However, a model developed by Laffont and Tirole (1991) linked an agency-theoretic approach to interest-group politics through government regulation.

In the second dimension, transaction costs are associated with the property rights literature pioneered by the work of Coase (1960), Alchian (1959, 1961), and (Demsetz, 1967) [as cited in Nabli and Nugent, 1989, p.1336]. This literature explains the effect of technological and

negotiation, communication) and the indirect costs (monitoring, enforcing) of the contract. Also, it might include ex ante costs arising from "adverse selection". The latter means (within the context of insurance), that people who accepted the insurance premium in a given insurance programme will be those with insurance risks exceeding the stated premium. Thus, it will affect the financial viability of any given insurance programme.

²²Opportunistic behaviour occurs when one party in a contract has the incentive to bend, circumvent or violate the terms of contract at the expense of one or more parties included in the contract. Cheating, shirking and opportunism explicitly or implicitly are all examples of opportunistic behaviour (Williamson, 1975, 1985).

²³For a study of the implications of this literature on public policy see Miller (1993).

pecuniary externalities on the evolution of institutional mechanisms which internalize externalities. These institutional mechanisms, called property rights, may reduce conflict, introduce cooperation and both reduce transaction costs (Nabli and Nugent, 1989, p.1336).

The third dimension related to the neoclassical political economy is concerned with institutional change and its effect on the performance of the economy. This literature is based on the work of North (1981, 1986, 1989, 1991). Here the definition of transaction costs is different from that adopted by Williamson²⁴. They are described as the cost of

"defining, protecting and enforcing the property rights to goods (the right to use, the right to derive income from the use of, the right to exclude, and the right to exchange" (North, 1991, p.28).

In contrast to the assumption of the utility-maximizing individuals adopted by the international trade theory and the public choice theory, institutions in this approach are the main factors which shape the repeated interaction of individuals in the political, social and economic structure²⁵. As a result institutions tend to create order

²⁴This dimension of transaction cost is associated with the University of Washington. Introduced by Cheung (1974, 1983) and elaborated, modified and developed by Barzel (1982,1989), Leffler and Klein (1981), Hashimoto (1979) and North (1981, 1984) (as cited in North, 1991).

²⁵Institutions are defined as "rules, enforcement characteristics of rules, and norms of behaviour that structure repeated human interaction (North, 1989, p.1321).

and reduce the uncertainty derived from cheating, shirking and opportunism, which constrains the choices of individuals (North, 1989, pp.1320-1321). Moreover, such institutions will determine the degree of transaction and production costs in a society.

In any structure of property rights, there will be positive transaction costs but, with growing specialization and division of labour, societies tend to establish, specify and enforce a structure of property rights which minimizes transaction costs.

In modern Western societies the establishment of well-specified and well-enforced property rights led to high rates of growth and development while in traditional societies with dense social networks exchanges tend to be personal. As no specified property rights exist, transaction costs tend to be low while production costs are high because of limited specialization and division of labour. As a traditional society develops, the cost of transacting will rise because information is costly and asymmetrically held by the parties to exchange. The incentives to cheat and indulge in free-riding will also increase without specified property rights and this will lead to imperfect markets.

The question is: who determines the specification and enforcement of property rights? According to North, the development of the state as a third, unbiased party is the most important factor in the establishment and enforcement of an efficient structure of property rights. The second

factor is the development of norms to constrain the parties in interaction where high measurement costs, even with the existence of the government, pose problems (i.e., opportunistic behaviour) (North, 1989, p.1320).

North argues that

"the new institutional economics must not be only a theory of property rights and their evolution but a theory of the political process, a theory of the state, and of the way in which the institutional structure of the state and its individuals specify and enforce property rights" (North, 1986, p.233).

Effective government is, therefore, an essential factor in economic performance, but the problem with the state, as North observed in his study of the history of political systems is that the rise of state power leads to the production of an inefficient structure of property rights and with it an unequal distribution of coercive power to the advantage of special interest groups. There are two reasons for such behaviour. The first is the transaction costs constraint. Inefficient property rights provide an easier system for raising revenue for the state with much lower monitoring and collection costs. The second reason is the powerful interest group constraint. In other words rulers can seldom afford efficient property rights because they may offend their constituents and risk their security.

As a result such a structure of property rights does not produce economic growth (North, 1991, p.7).

In comparison with world economic history the contemporary state's role in developing countries is seen to be similar

to the model which has prevailed throughout history.

"The opportunities for economic and political entrepreneurs are still a mixed bag, but they overwhelmingly favour activities that promote redistributive rather than productive activities, that create monopolies rather than competitive conditions, and that restrict opportunities rather than expand them" (ibid, p.9).

The conclusion of this theory is that unless government establishes, specifies and monitors an efficient system of property rights, similar to those existing in the Western world, free markets will not equate with efficiency. Efficient markets require unbiased governments which build in incentives to create and enforce efficient property rights while minimizing transaction costs in order to achieve growth and development.

The work of North (1981) led to another explanation for the behaviour of the state. This rests on the rational-choice assumption and in the literature is called the predatory rule of the state (Levi, 1988)²⁶. Levi studied the history of state revenue production. She focused on rulers as revenue maximizers subject to changing constraints. She argued that "rulers are predatory in that they try to extract as much revenue as they can from the population" (Levi, 1988, p.3).

The constraints on rulers are similar to those introduced by North as impeding the existence of efficient property rights (transaction cost and bargaining power), but with

²⁶For a more recent review of this literature see Cammack (1992).

an additional one described as the discount rate constraint. The latter deals with rulers' calculations through the time horizon of the value of present against future revenues. Levi's argument is that rulers redesign their structure and policies to achieve the goal of revenue maximization.

"Rulers will design institutions that they believe will be efficient in promoting their interests (which may overlap-but need not-with the general welfare or with the interests of a dominant class). More specifically, within the limits of the constraints upon them, they will devise revenue production policies that maximize revenues to the state. However, as relative prices change, institutions that once facilitated exchange may begin to hinder exchange or reduce return. Rulers will then try to redesign state structures and rewrite state policies" (Levi, 1988, p.16).

For that reason the implication of this approach is that the state through its rulers will establish a structure which increases its bargaining power, reduces its transaction costs, and lowers its discount rates in order to capture gains from exchanges of politics.

However North's approach criticized public choice theory for its assumption of individual rationality because the latter should be understood within the context of institutional factors which determine such behaviour (North, 1991, p.108).

Public choice theory started from a given structure of property rights which characterised the sphere of the Western countries and consequently led to the minimization of transaction costs, the key factor determining economic performance. Thus, it was not free market and rational

choices but efficient institutions which led to rational choices based on efficient information and secured exchange in the market place.

Institutional change occurs gradually rather than in the form of revolutionary breaks with the past and a result of change in relative prices. However, the interest group factor as well as the calculation of the rulers plays an important role in the construction of inefficient and growth-hindered systems of property rights. Rulers may initiate an institutional change without interest group pressure if the factor of ideology is costless (North, 1981, p.53)(North, 1991, p.138).

Matthews (1986) argues that institutional change has made a positive contribution to economic growth. But the presumption that the pursuit of self-interest tends to promote the evolution of efficient institutions is not totally correct because the involvement of the state with institutions is inherent (Matthews, 1986, p.910).

In comparison with the other NIE schools, this one is more pragmatic. It does not disregard the role of the state and can explain the existence of inefficient markets in developing countries as well as the role of the state in maintaining such inefficiency.

Moreover, even in the developed world the theory can provide a good analytical framework for the assessment of a governmental policy role.

Russer (1992) examined the factors behind the incoherence of United States agricultural policy and observed that the

reason was the combined role of the government as both predatory and productive. In behaving as a predatory, the government will concentrate on policies leading to the transfer and redistribution of wealth towards its interest groups. Such behaviour does not lead to efficiency but rather assists to acquire balance and secure political power. On the other hand, other governmental activities are concentrated on the efficiency factor. The combination of both roles has led to the incoherence of the agricultural policy in the United States.

In developing countries, studies in the development of land property rights, such as Feeny's (1988), can demonstrate how contrasting systems of property rights have produced different responses to a common set of relative prices. Feeny examined the spread of state bureaucracy into the rural hinterlands of South and Southeast Asia in the late 19th century. He argued that market prices established the value of productive assets, and a shift in market prices led to a change in the relative valuation of assets. As the latter increased in value, people responded by demanding security through a share in the legal rights of the assets. As South and Southeast Asia became drawn into the world economy in the late 19th century, relative prices, which dominated in the international market, started to dominate domestic economies. Because the structure of prices favoured agriculture, resources were directed towards establishing

rights in land. This was because privately owned land would be more efficient than one without property rights. There was in other words a need for state intervention to supply the demand for such rights. But the problem, as addressed by North and Levi in the analysis above, is how and why rulers provide efficient property rights. Feeny found out that Thai officials who established the system of property rights were themselves land owners. Thus, the private interests of the bureaucrats as well as the rulers led to the development of a new system of property rights. Another study by Ruttan (1989) shows that changes in relative resource endowment (i.e., population and land) and technical change (i.e., irrigation system and high-yielding price varieties) lead to shifts in the demand for institutional change. The supply of institutional innovations responded to such new demands by a shift from share to lease tenure in the Philippines between 1966 and 1976. It brought about the emergence of a subtenancy arrangement because the leasehold arrangement paid rents to the landlord below the equilibrium rent (Ruttan, 1989, p.1378). The emergence of another efficient resource allocation system (gamma system), as a result of the supply of complete private property rights, was an institutional innovation "designed to reduce the wage rate for harvesting to a level equal to the marginal productivity of labour" (ibid, p.1378). However, such a

system increased efficiency but not equity²⁷.

In summary, the neoclassical political economy or the NIE has emphasised that "government failure" in development is greater than the presumed "market failure". Thus, the role of the state has to be minimized to provide a protective role similar to the one advocated by Adam Smith more than two centuries ago.

Although the analytical frameworks were different between the different NIE theories, the shared belief of this literature in liberalization, privatization and export-oriented policies has led the international donor agencies as well as the Western countries to support a market-oriented approach toward development which minimized the role of the state to that emphasised in the literature discussed above. To support their claim the neoclassical theorists have emphasised the story of success in the East Asian countries as evidence for their theoretical justification of less state and more market. Such views on the role of the state in East Asian countries have come under attack from a number of theorists who believe that the governments of those countries had in fact played a major role in development. Another dimension of this literature has recommended a new role for the state in development which is more than minimalist. This literature

²⁷Bardhan (1989) provided an important review of the empirical literature as well as a comparison between the Marxist and Neo-Marxist theorists views with that of the NIE school.

underlines a counter-counterrevolution in development economics.

1.5: The Counter-Counterrevolution²⁸

The story of development success in the East Asian countries was one of the main factors in support of the case of liberalization. It was perceived as the only cure for the problems of development in developing countries. Other economists, however, realized the importance of government intervention in guiding the success of those economies.

Wade (1990), in his theory of the governed market (GM), has claimed that the high economic performance of East Asian countries was the result of a level and composition of investment different from that which free market policies per se, and interventionist policies per se would have produced. The role of the state was a combination of direct investment in certain key industries in the initial phase of development and a package of policies which employed certain incentives, controls, and mechanisms to spread risk. The latter role enables the government to guide or govern the market processes of resource allocation in order to achieve efficient investment and production results. Contrary to what neoclassical political economists argued Wade said that

²⁸The term has been used by Krugman (1993).

"Government policies deliberately got some prices "wrong", so as to change the signals to which decentralized market agents responded, and also used non price means to alter the behaviour of market agents. The resulting high level of investment generated fast turnover of machinery, and hence fast transfer of newer technology into actual production" (Wade, 1990, p.29).

Thus, it was not simply "get the price right" and a minimum role for the state that resulted in the exceptional achievements of those countries.

As Luedde-Neurath (1988) argued, it is the "directive" as opposed to "promotional" forms of state intervention that led to the Korean success (Luedde-Neurath, 1988, p.102). Cases of important state intervention can be found in other East Asian countries such as Singapore, Taiwan and Hong Kong (Appelbaum and Henderson, 1992).

The other, and perhaps the most important, state intervention was the "land reform" programme to redistribute agricultural land in the initial phase of development (Wade, 1990) (Koo and Kim, 1992). This land reform has led to the elimination of the landlord class and to the creation of a relatively egalitarian class structure. Sachs (1989) argued (as cited in JR.James, 1992) that the broad distribution of land in East Asian countries has contributed to the adoption of an outward-oriented industrialization while in the case of Latin American countries the unequal distribution of land led to a resistance against the devaluation of exchange rates because that would have result in the transfer of income from workers and capitalists to a small elite of landlords. Thus, in Latin American countries, overvalued

exchange rates continued ISI policies which ultimately led to the failure of economic development in Latin America (JR.James, 1992, p.247).

Morris and Adelman (1989) also observed, in their comparative quantitative study of 19th century economic development, that development is more dependent on effective initial institutions and human resources than on other major sources of growth (i.e., market systems, export policies and capital inflows). As a result the shift in development strategy towards free markets and export orientation can impose losses on the majority of the population "if pursued in countries where institutions cause a very narrow distribution of the proceeds from economic change" (Morris and Adelman, 1989, p.1428). Thus, the role of the state in East Asian countries has to be understood through the study of their institutional designs and the historical institutional changes which have provided the basis for their success.

While the problem of the neoclassical political economy is its concentration on the extent of state intervention there is a need to concentrate on the quality of that intervention (Bardhan, 1990)(Israel, 1991).

To provide an example, Krueger (1990) argued that "government failure" in developing countries was due to two reasons, the first being commission (widespread state intervention in productive activities) and the second omission (deterioration of the infrastructure). The

solution according to Krueger is to understand the comparative advantages of state intervention. In large scale activities such as infrastructure and the provision of information the state is in a good position to intervene successfully. However, Krueger is one of the strong advocates of a minimalist state role. The question, therefore, is whether the comparative advantage activities of the state as advocated by Krueger can be carried out by a passive or minimalist state?

One of the major characteristics of the market is that it cannot by itself create the appropriate industries, or strategic investment. Thus, there is a need for direct government intervention. However, government intervention in the production process has to be decided pragmatically. In the Korean case the government intervenes through its SOEs for three reasons. Firstly it intervenes if there are no private parties willing to take the risk; secondly, there is a desire to exercise control over an industry with multiple linkages; and thirdly, there is the expectation that the negotiation position of the state with foreign parties is better than that of private investors, particularly in the supply of capital and technology (Westphal, 1990).

Such intervention, had the Korean government followed the recommendation of the neoclassical political economists, would never have been achieved.

One of the major advantages from such intervention was the apparent success in the process of learning and acquiring

technological capabilities which, as Bardhan said, "belong to the core of the development process" (Bardhan, 1990, p.4).

Another important dimension in this literature is the importance of understanding the main focus to be the organizational structure and institutions rather than getting the price right. The failure of the earlier high development theory in identifying the informational problem at the micro level and the neoclassical political economy in identifying the problems of externalities leads to different conclusions on the role of the state if they are taken into account in the analysis; namely that the role of government in establishing non-market institutions is necessary to solve the problems of information, coordination and externalities, particularly in the context of developing countries. That is to say, in developed countries many of the externalities are internalized by non-market institutions (Stiglitz, 1989) (Bardhan, 1990). This was the case in South Korea where the relationship between the government and large private enterprises constituted a quasi-internal organization. The same could be said about Korea's financial system. It was an internal capital market which allocated the resources more efficiently than would have been possible in a free-market financial system (Lee, 1992). In the same context, Doner (1992) argued that the institutional approach should understand the state as a component of the institutional arrangement rather than as an exogenous actor.

Thus, the role of the state in development is both to reduce the wastage of resources and to initiate the institutional building process. In other words there is a need for the cooperation of rather than the domination of the state. To achieve broader institutionalism there is a need for a framework which combines private and public sector arrangements, appreciates the coalitional bases of such arrangements, and observes the importance of providing political support for local firms as well as pressurizing them to use market forces (Donar, 1992, p.401).

As Datta-Chaudhuri (1990) argued, economic agents "do not always correctly perceive the various trade or technological possibilities open to them" (Datta-Chaudhuri, 1990, p.33). However, the possibility of successful state intervention cannot be generalized in all cases. The justification will depend on the composition of interest groups and their affect on the allocation of resources. In the cases of South Korea and Taiwan, those interest groups were directed more towards productive than distributional activities (Castells, 1992) so they have not only increased their share of the aggregate output but also increased the size of the aggregate output itself for the society.

The analysis of economic performance in South East Asian countries has to be related to another important concept of the state. That is the concept of "strong" and "soft"

states²⁹.

In economic terms, strong states would be expected to be more effective in taking correct economic decisions with little regard for their political and social consequences. Soft states, on the other hand, would employ ineffective regulatory policies to protect incomes and avoid social conflict. Thus, in Singapore, South Korea and Taiwan where the states have been authoritarian and strong, high economic records have been achieved. In India and Mexico on the other hand, soft states have led to ineffective intervention and increased corruption. It follows that free-market oriented policies have more need for a strong state than for a soft one and consequently the state has to move beyond the limits of the minimalist state advocated by the neoclassical political economists. This inconsistency is apparent in this quotation from Lal (1983) who said that in order to achieve efficiency " a courageous, ruthless and perhaps undemocratic government is required to ride roughshod over the newly-created special interest groups"(Lal, 1983, p.33). Such characteristics of government have to be viewed in the context of North's analysis of the state. The result will be an authoritarian government with an inefficient property rights structure.

²⁹The concept is attributed to Myrdal (1968) who observed that the states of South Asian countries were not effective in their performance because of their undisciplined societies which need stronger states to enforce the rules and regulations and achieve better economic performance (Myrdal, 1970, pp.229-230).

Fishlow (1991) contended that the capacity of autonomous and developmental states in South East Asia has to be understood within their institutional and historical context. In comparison with Latin American countries the public sector in the East Asian countries "was not an employer of last resort, nor was it weakened by lack of access to resources" (Fishlow, 1991, p.167)

Another attack on the neoclassical political economy approach came from Banuri (1991). He argued that the main deficiency of the neoclassical approach was its failure to assess the conditions under which the state can play a positive role.

"Beyond creating (minimalist) rules to enhance the market, there is no policy advice. Nor, except for resort to authoritarian tutelage, is there guidance about creating and sustaining political support, even for liberalization"
(Banuri, 1991, p.12).

Unlike, the neoclassical political economy Shapiro and Taylor (1990) explained the conditions which delimit appropriate strategic choices for the state. These conditions are country size, internal vs. external constraints, wages and income distribution, fiscal and managerial capability of the state, industrial heritage, and finally productivity growth and access to technology. They argued that there is a peculiar asymmetry in the DUP model. While they successfully presented the argument that market failure is not automatically a justification for government intervention, because it may produce even worse results, they neglected to state that "government failure" cannot justify the argument for a free market.

"Whereby individuals coalesce to force a political redistribution, but do not do the same in the market place. The political arena is depicted full of lobbyists and cartel builders, while the economy is presented as being more or less subject to competition" (Shapiro and Taylor, 1990, p.876).

Taylor's (1991) expectation is that the development strategy of the next decade will be inward-looking. Lack of access to external sources of capital, particularly for heavily indebted countries, and a growing protectionism in the Northern countries may lead developing countries, especially small and poor ones, to lack the necessary stimulus for their development process.

Thus, there is a need for more government investment in the agricultural sector to encourage private investment (Taylor, 1993). A similar emphasis on government role in the agricultural sector was raised by Adelman (1984). She argues that a strategy of agricultural-demand-led industrialization (ADLI) might prove to be more efficient than a strategy of export-led growth, after the initial stages of industrial development, in most middle-income countries and large low income countries.

The role of the state through direct investment programmes can enhance the supply of the domestic agricultural sector (surplus creation rather than surplus extraction).

The argument in favour of the need for government provision of infrastructural investment was also advocated by Fenichel and Smith (1992) in their study of the failure of integrated rural development in Zambia. They argued that

"The argument that agricultural problems in Zambia, and other developing countries, are due to market distortions caused by government intervention ignores too many factors that bear of farming efficiency" (Fenichel and Smith, 1992, p.1318).

Another advocate of an important role for the state within the context of rural development is Chambers (1991). He argued that the universal functions of the state are to maintain peace and the democratic rule of law, provide a basic infrastructure and services, and manage the economy.

Another dimension in the literature of counter-counterrevolution is a theoretical one. Krugman (1993) argues that recent neoclassical literature has neglected the importance of externalities and linkages for the economy³⁰. The blind advocacy of free market policies and the emphasis on "government failure" in development has directed the literature away from the high development theory of the 1940s and 1950s. Krugman argues that the theoretical ideas of external economies, strategic complementarities, and economic development, which have been forgotten, may continue to have practical applications and should be revived. He has explained that the failure of formalizing models in support of the high development theory and the failure of the industrialization idea as the essence of development were the major reasons for neglecting the 1940s and 1950s theories of development.

³⁰Similar argument produced by Taylor (1991, p.109).

Krugman's model of forward and backward linkages shows that the concentration of manufacturing industries in one region is due to factors of allocation (interaction of economies of scale with transportation costs) in the larger market (backward linkages) and the desire of workers to have access to goods produced by other workers (forward linkages) (Krugman, 1991). Also, the greater the degree of economies of scale, the stronger the tendency towards concentration (Krugman, 1993).

This model helps to emphasise the important role of government promotion policies in directing investment towards rural areas in order to induce the development of such regions, which depends on the strategic complementarity argument.

Another model has emphasised the important role of pecuniary externalities in escaping the no-industrialization trap in small economies. This was introduced by Murphy, Shleifer and Vishny (1989). This model explored Rosenseteir-Rodan's idea of the big push and introduced it in a formal model. It explained how economies with small domestic markets could expand their markets in order to escape the no-industrialization trap. The focus of the model was on the contribution of industrialization of one sector to expanding the size of the market for other sectors. Such an analysis gives rise to an important role for the state in coordinating investments across sectors which is essential for

industrialization.

The argument of the model is that the profit factor alone cannot induce firms to invest as they lack the advantages of economies of scale (the market size constraint). The result is a no-industrialization trap. On the other hand, a firm which employs labour from the traditional sector will enlarge the market of other firms by increasing wage income and consequently the demand for manufactured goods.

As a result

"a programme that encourages industrialization in many sectors simultaneously can substantially boost income and welfare even when investment in any one sector appears unprofitable" (Murphy, et al., 1989, p.1024).

The second theme of the argument is concerned with another important pecuniary externality. That is the one generated by investment in "jointly used intermediate goods" such as infrastructural investment and investment in training facilities (ibid, p.1006). State provision of such investment is necessary, and its high fixed cost would be reduced if industrialization took place. This latter is possible because many firms will use the facilities and enable the government to recover costs, if not necessarily show a profit.

The spirit of this model is consistent with that of high development theory. The emphasis on externalities, and on economies of scale, were important factors in the theories of the 1940s and 1950s. Such a model seems to run counter to the minimal state role in neoclassical political economy.

Another criticism of the neoclassical political economy stems from the literature of the new growth theory (Romer, 1986). Romer assumes that the social returns on investment are higher than private returns because of external economies. In this model, technological externalities are the driving force for long-term growth. However, these externalities arise through the accumulation of knowledge (endogenous technological change). Exogenous technological change is ruled out of the model. The consequence is that any intervention by the state which results in shifting **"the allocation of current goods away from consumption and toward research will be welfare-improving"** (Romer, 1986, p.1026). *The role of the state in raising beneficial technological externalities is important for long-term growth, by fostering investment in knowledge and human capital. Such an argument contradicts the minimal state argument of neoclassical political economy.*

The implication of these models, as Krugman (1993) argues, is that the economic theory of the free market is not always the best but that **"there is an intellectually solid case for some government promotion of industry"** (Krugman, 1993, p.32). Also, there is a need for a reorientation of research towards failures of both market and government rather than just on "government failure" alone.

Streeten (1993) pointed out Adam Smith's admission that rent-seeking is also common in the private sector and that

government action may contribute to its elimination. Policies such as anti-monopoly and anti-cartel legislation, import liberalization and the introduction of competition in the public sector are examples of such anti rent-seeking. He also refers to Baghwati's argument that the creation of new rents can reduce or altogether destroy existing rents and existing rent-seeking activities (Streeten, 1993, p.1292)³¹.

Another criticism of rent-seeking theory (within the context of rural villages in Asian countries) was provided by Lipton (1989). He argued that there is a rent-avoiding process which runs in parallel with rent-seeking behaviour. For example, villagers can reduce the rent payable to the local monopolistic moneylender, by searching for alternatives which reduce their dependency on rents (e.g., by adopting a less credit-intensive product mix). Thus, the rent would be reduced (Lipton, 1989, p.1564).

Streeten's and Lipton's analyses provide arguments against the case for the minimalist state. In the final analysis Streeten argues that "for the proper working of markets, strong, and in many cases expanded state intervention (of the right kind, in the right area) is necessary" (Streeten, 1993, p.1281). What is needed is a fundamental structural change, a redistribution of assets and of access to power which neither the market alone, nor a

³¹For further criticism of the theory of rent-seeking and DUP activities review Samuels and Mercurio (1984), McPherson (1984), and Miller (1992).

neutral state, can provide. Hamilton (1989) argued that the theoretical generalization about the value of liberalization in Third World countries is incorrect because the institutional differences between Western and Third World countries are far greater than those assumed by the theory. Furthermore, he believed that liberalization is irrelevant within the context of developing countries where the need is more for an institution building process to enhance economic efficiency.

It is surprising that agencies such as the World Bank have been advocating free market policies, and arguing for the simultaneous eradication of poverty and an increase in participation of the poor in growth (*World Bank, 1990*). In the face of such asymmetric advice, there is a need for a minimalist state for the first and an interventionist state for the second. The poor lack access to assets and particularly land. This implies a need for a better and more equitable asset distribution which has to be initiated by the state. The latter is what Bhagwati (1988) argued for when he advocated a minimalist state. It is difficult to see consistency between such different suggestions.

The following quotation from Banuri (1991) suggests a reason for "government failure" in development. He said that

"The failure of a state does not derive from its refusal to adhere to a theoretical dogma. On the contrary; it derives, in the short run, from its abandonment of the goal of governance in favour of theoretical certitudes; and in the long run, from its inability or unwillingness to create or modify institutions to facilitate the management of conflicts which are forever changing in the form and intensity" (Banuri, 1991, p.36).

1.6: Conclusion

In this chapter, a survey of the literature on the role of the state in development suggests that the theoretical analysis is problematic. This derives from the complexity of the subject itself. However, it is possible that the literature is moving into a cyclical pattern as observed by Hirschman (1982).

During the 1940s and 1950s, development economists explained the process of development in terms of growth, industrialization and capital accumulation but there was no analysis of the institutional context for such development. However, the failure to carry out successful industrialization in developing countries, has led the literature of high development theory to be put aside in favour of the neoclassical approach to development. The problem with this approach is that it provides a generalized approach based on the belief in a minimalist state. However, the introduction of the New Institutional Economics (NIE) has provided a good analytical framework for understanding the role of the state as one of the several institutions which has to be included in the

theoretical argument³².

The problem was that the state in some of the schools (i.e, public choice and DUP) became an exogenous rather than an endogenous actor in development. In other theories such as transaction costs and property rights, the state was employed in the analysis of institutional change. The result was an abandonment of the concepts of externalities and strategic complementarity towards one concentrated on "government failure" caused by competitive rent seeking and the collective action of special interest groups. The consequences of this analysis became apparent in forcing developing countries to adopt free market policies as a reaction against government failure.

The recent literature of the 1990s shows that a minimalist state cannot provide the conditions required by the neoclassical political economists. The emphasis has been placed on understanding the reason behind the development success of the East Asian countries. Free market policies appear to have been not the only reason for such success; other interventionist policies have also been required. It is necessary to understand each country's special circumstances because the late-comers' conditions and challenges may be entirely different from those which have already achieved successful development. A revitalization of the economic concepts used in the high development theory of the 1940s and 1950s might provide a good guide

³²For a sophisticated discussion of the importance of the new institutional economics in evaluating the role of the state, read Handoussa (1993).

for a new role of the state in development. It will be different from the previous role and better in the quality of actions. However, decision makers should look for long-term objectives rather than depend on policies for short-term goals. The role of the state then becomes strategic rather than crisis-driven.

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Chapter 2

Public Versus Private Ownership: The Economic Rationale For Privatization in Developing Countries

- 2.1: Introduction**
- 2.2: The Allocative Role of the State**
- 2.3: The Origins of Public Sector Growth**
- 2.4: Evidence on Public Enterprise Performance**
- 2.5: The Theory of the Firm**
- 2.6: The Theory of X-Efficiency**
- 2.7: The Economic Theory of Property Rights**
- 2.8: The Principal-Agent Theory**
- 2.9: Conclusion**

2.1: Introduction

In the preceding chapter it was asserted that the role of the state in development has expanded, partially, through the intellectual dominance of the high development theory during the 1940s, 1950s and 1960s. One of the major consequences of this theoretical dominance was the creation of state-owned enterprises (SOEs) in the developed and developing countries. Such a theoretical explanation provides only one side of the economic rationale for the role of the state. Another analytical tool which can assist in understanding the expansion of the public sector in mixed economies derives from the theory of public economics.

Thus, the chapter will commence by presenting the theoretical justification for the allocative role of the state.

The 1950s, 1960s and 1970s were characterized by a rapid expansion of the public sector in the developing countries similar to that which had taken place in Europe during the 1940s. Within this context the subsequent section will respond to the following questions: What were the main reasons for such an expansion? Did they reflect a theoretical dogma or did other factors have a significant impact on the process? Were the reasons for the growth of the public sector identical in all developing countries?

In relation to privatization which represents the main

subject under investigation, the thesis will adopt two concepts of privatization which serve two main objectives.

The first objective is the effect of privatization policies on the economic performance of SOEs. In this domain privatization is defined as the transfer of ownership and/or control (whole or partial) from the state to the private sector. This definition of privatization does not include SOE reform programmes or deregulation and liberalization policies because these necessitate neither a change in control and ownership nor a change in the source of supply for goods and services. Such a definition employs the term privatization simply as a means of divestiture.

The second objective of the thesis is to analyze the effect of privatization on economic development within the context of decentralization. In this domain, privatization is considered to be functional decentralization, as opposed to territorial decentralization, namely the decentralization of decision making from the state to the market.

This chapter will employ exclusively the first definition of privatization in order to study the effect of ownership change.

The analysis will be divided into two major fields.

The first will provide a review of the empirical evidence

regarding the performance of public enterprises in developing countries with the aim of establishing whether the record of public enterprise performance worldwide provides solid and conclusive evidence for the superiority of private ownership. It will also examine whether profitability means economically efficient.

The second area of investigation will be the economics of privatization within the context of ownership change.

The purpose of this chapter is to argue that the really significant differences in efficiency lie not in the realm of ownership change but in the institutions which affect the degree of competition in the market.

2.2: The Allocative Role of the State

Traditionally, the economic analysis of SOE pricing and investment policies was concerned with allocative efficiency and thus had a welfare economics orientation. The theory of public economics justifies the allocative role of the state in those activities which escape market logic. This is referred to as Pareto efficiency.

Pareto efficiency is the optimum allocation of resources where no one individual can be made better off without another individual being made worse off. Pareto efficiency rests on the assumption of a competitive equilibrium. This latter is a set of outputs, inputs and prices of factors and commodities where producers cannot increase their profits at the prevailing equilibrium prices with the available production technology. Nor can consumers improve

their welfare because of their budget constraints. Both require that there is no excess in demand or supply of any commodity or factors which would affect equilibrium prices.

This pareto efficiency can only be achieved under certain conditions such as output priced at the marginal cost of production, no economies of scale, absence of externalities in production or consumption, divisibility, absence of risk and uncertainty in both technology and taste¹.

Market Failure

When the market of any economy fails to meet the conditions required for pareto efficiency (first-best solution), government intervention, at least in principle, will be justified to correct the failure of the market (the second-best solution). Thus, government will intervene when the competitive market mechanism fails to provide an efficient allocation of resources.

The causes of "market failure" are traditionally grouped into four main categories, namely the existence of public goods and externalities, economies of scale, information asymmetries, and uncertainty. These four causes of "market failure" imply two different kinds of state intervention leading to state ownership in the first two groups and regulatory intervention in the second two. However, it is

¹For a more detailed analysis of the conditions of pareto efficiency, see Brown and Jackson (1990, pp.18-24).

difficult to draw the demarcation line separating state intervention through direct production from intervention through regulation because this will depend on the judgement of policy makers as to what is appropriate to correct a "market failure"².

Traditionally, state ownership has been justified mainly on the grounds of public goods production and on the existence of a natural monopoly. The main reason for a failure to produce public goods is lack of cooperation between individuals in the market place. The main characteristics of public goods and externalities are non-excludability and non-rivalness in consumption.

In the case of public goods these characteristics lead to the free-rider problem where individuals cannot be excluded from the consumption of such goods (e.g. a lighthouse) while non-rivalness derives from the indivisibility character of these goods as well as the zero opportunity cost for the marginal user which means that the price of public goods should be nil (e.g. a non-crowded bridge). As a result governments will provide these goods because the market itself will fail to allocate them efficiently as they are unattractive to private entrepreneurs. In the case of externalities, the market will fail to produce goods associated with external economies (e.g. health, education, infrastructure) while over-supplying goods which imply external diseconomies

²For example in the United State policy makers tend to intervene through regulations, while in other countries, such as Britain, through direct ownership.

(e.g. pollution). The reason for "market failure" in these cases derives from the high transaction costs of introducing voluntary agreement between individuals and the lack of well defined property rights which can preclude the free-rider problem (Demsetz, 1967) (Demsetz, 1988).

The second reason for state or public ownership derives from economies of scale or what is called the existence of decreasing cost industries. In this case the market solution of production through several producers would be inefficient (bearing in mind the size of the market) because marginal cost pricing in such industries will not cover the cost. As a result, producers will cut production and increase prices leading to a departure from the first best conditions of pareto efficiency. As a result, governments will act directly on such industries through direct ownership in order to employ pricing policy rules which can achieve a more efficient allocation of resources. However, this solution is inferior to the direct regulation of monopolies (Rees, 1989, pp.29-44). The direct provision of public utilities (e.g. water, electricity) is an example of such an allocative role for the state. However, in addition to economies of scale, many natural monopolies possess economies of scope which arise from the joint use of a central facility for the production of different products (Brown and Jackson, 1990, p.44). Governments invest in infrastructure facilities because of such characteristics.

It could be said that the theoretical justification for state ownership rests on allocative efficiency considerations rather than those of technical or productive efficiency. The latter are concerned with minimizing input requirements or costs for a given level of output. However, allocative efficiency will be violated in the absence of technical efficiency although the converse does not hold. In other words technical efficiency is a necessary condition for allocative efficiency, but the latter is not a necessary condition for the former.

Privatization has therefore been introduced as a means of achieving technical efficiency based on the assumption that SOEs do not operate in a cost-minimization manner.

Before presenting the theoretical justification for privatization, it is important to investigate the reasons vindicating the creation and expansion of the state sector in developing countries and to establish whether market failure was the main reason behind the expansion of SOEs. Is it possible to treat the public sectors in those countries in a similar manner or is there variance in their age and structure?

2.3: The Origins of Public Sector Growth

The expansion of the public sector in developing countries has been a feature of the post WW2 era and theoretically more symmetric with the influence of the development

theories throughout the 1940s, 1950s and 1960s. But, there is a difference between the approach advocated by the theory of public economics, as discussed in the previous section, and that of development theories.

In the theory of public economics, public sector activities are subjected to the achievement of pareto efficiency and its aim, therefore, is to define the minimum position that the public sector should occupy in a market economy. Such a context, by contrast, cannot be found in the high development theory which is concerned with generating economic surplus, filling the gaps in private investment, and pursuing economic and social objectives. Nevertheless, there are activities where both theoretical approaches allowed to be provided through the public sector (i.e. infrastructure, public utilities).

Thus, the allocative role of the state which stems from the theory of public economics excludes the historical background to the formation of the public sector as well as the dynamic play of the institutional factors which were behind its creation in different developing countries.

2.3.1:Nationalization

After political independence, many developing countries nationalized enterprises owned by foreigners and the wealthy upper classes. Nationalization was seen as a major component in the drive towards economic independence and one of its consequences was the expansion of the public

sector.

However, the history of nationalization differs from country to country. In Latin America the process started during the 1930s (e.g. Mexico and Bolivia) while in Africa and Asia it began after the period of political independence, that is during the 1950s, 1960s and 1970s (e.g. Tanzania, and members of OPEC). Thus, the age of the public sector in those countries is not the same.

The economic case for nationalization was based on increasing the saving ratio and obtaining the rents derived from natural resources which had previously been absorbed by foreign companies. When nationalizing local private enterprises the aim was to reduce the consumption of the upper class elite and redirect the resources towards public investment. Yaffey argued that:

"The requisite circumstances are, first, that the elite formerly enjoyed relatively high incomes; second, that they enjoyed a high average propensity to consume; and third, that the new system can make effective use of the funds diverted into national development budgets" [(Yaffey, 1969) as cited in (Yaffey, 1992, p.3)].

Nationalization had, therefore, played a significant role in raising state revenue on the one hand and supporting the expansion of the public sector on the other.

Furthermore, a recent econometric study conducted by Andersson and Brannas (1992) on the relationship between nationalization and foreign investment flows to 13 developing countries revealed a positive relationship between nationalization and investment flows, particularly during the peak period of nationalization in the 1970s.

However, the authors also stated that the factor of heavy indebtedness in some developing economies impeded investment flows and thus counterbalanced the positive effects of nationalization.

Nationalization was, therefore, an important means for the leaders of developing countries to increase foreign exchange revenue as well as to attract new foreign investments.

2.3.2: The Ideological and Political Factors

In developing countries many leaders were influenced by socialist thinking, and particularly by the Soviet model of industrialization.

In India, the expansion of SOEs was seen as the only way to achieve industrialization and economic independence (Mulji, 1990). Investment in heavy industries and increasing state intervention in other economic sectors also derived from the notion of building a new national identity and self-sufficiency.

Government was seen as the representative of the people and its owning the means of production was a notion of anti-capitalist exploitation.

On the other hand, public sector expansion also enabled the rulers of the newly independent states to exercise control. The legitimacy of the ruler or the government derived from popular support for Pan-Nationalism (Sandbrook, 1988). In this way emphasis on socialist planning was an essential ingredient in the public

ideology of countries heavily embarked on statist, integrative programmes of national development and control.

Yet, this model of an interventionist state was inherited from the colonial powers. Nellis commented on Sub-Saharan Africa that "the national elites which came to power... were thoroughly accustomed to a legally strong, hierarchically intrusive governing system" (Nellis, 1986, pp.12-13). In some developing countries this factor played a major role in increasing the number of SOEs. However, it may be inappropriate to generalize such a factor to all developing countries because most Latin American states, for example, did not believe in socialism. Furthermore, during the 19th century and also the beginning of the 20th century, the Latin American region was an integral part of the world economy through its adoption of export-led development (Trobat, 1983). As a result, the private sector was an important participant in the development of the region until the end of the 1930s.

Such arguments demonstrate that the ideology of developing countries differed widely between the regions as well as within countries of the same region.

2.3.3: The Commanding Heights of the Economy

One of the reasons behind the expansion of the public sector in developing countries was the need to control the commanding heights of the economy. These heights are the key sectors of the economy which can stimulate

industrialization and growth and as a result cannot be left in the hands of the private sector (Vernon, 1988, pp.10-11). In infrastructural activities (such as the generation and distribution of energy, transportation and communication) and the heavy industries (such as oil and petrochemicals) control of the public sector is seen as essential for the provision of external economies and strategic complementarities which can encourage investment in other sectors (Powell, 1987, p.6).

Another justification for state control of the commanding heights was that it supported the facilitation of long-term economic planning and provided a substitute for market forces by establishing priorities for the development of major activities and sectors in the economy (Rees, 1989, p.5)³. In Mexico, for example, the government tried to make a distinction between strategic and priority sectors. In the former (e.g. oil extraction, refining, basic petrochemicals) the public sector obtained an exclusive monopoly position for their operations while in the priority sectors (e.g. different medium industries) the state acted as the driving or the organizational force and obtained the right to act alone or in co-operation with the private or social sectors (Bouin and Michalet, 1992, p.38).

The argument of the commanding heights is an application

³This is not the case in all developing countries. In some countries the international aid agencies, such as the World Bank, demanded and insisted on a plan even though the planners themselves had little confidence in economic planning (Low, 1990, p.290)

of the theory of "market failure" in the provision of public goods and externalities as well as the ownership of natural monopolies. However, it is difficult to be sure whether the leaders of developing countries were in fact influenced by this theoretical justification provided by the theory of public economics.

2.3.4:Industrialization and Modernization

As the preceding chapter has shown, the development theories of the 1940s, 1950s and 1960s emphasised that the problems of development could be solved if saving and investment were directed towards the expansion of the industrial (modern) sector. The creation of a modern and diversified economy was analogous to breaking the bonds of dependence, saving and earning more foreign exchange and enhancing employment opportunities *so as to provide income* and promote the living standards of the population (Nixon, 1990, pp.312-313).

In most developing countries the state was the only appropriate candidate for such a role. Large investment was needed to build a modern industrial sector, for which the private sector possessed neither the resources nor the willingness to take risks in new technological activities. The consequence was heavy investment in capital intensive industries on the basis of modernization rather than the appropriateness of such technologies to the special features of each country. As a result SOEs in developing countries were characterized by higher rates of capital

intensity ratio⁴. To measure the capital intensity of SOEs, we have used the ratio "share of gross fixed capital formation" to the "share of GDP at factor cost". The capital intensity ratio of SOEs varied sharply between the developed and developing countries. While it was 1 for the SOEs in 17 industrialized countries, it was about 3 for the SOEs of 55 developing countries during the period 1974-1977⁵.

Moreover, there were differences between regions as table (2.1) shows. While in Asia and the Western Hemisphere the capital intensity ratio was about 3.5, it was about 2 in the African countries.

Table 2.1
The Capital Intensity Ratio of State-Owned Enterprises (SOEs) in Developing Countries Regions During 1974-1977.

Developing countries regions	Capital intensity ratio for SOEs*
1.Africa	1.9
2.Asia	3.5
3.Western Hemisphere	3.4

Source: calculated by employing the data in Short (1984, pp.116-122).

* Capital intensity ratio = Share of SOEs in fixed capital formation /share of SOEs in GDP at factor cost.

The sample comprised 17 African countries, 11 Asian countries, and 22 countries from the Western Hemisphere.

⁴The capital intensity ratio means the share of total capital employed to the total value added or the total output of an economic activity.

⁵Calculated by employing the data in Short (1984, pp.116-122).

Another dimension is the distinctive features and circumstances under which import substitution industrialization was adopted in different developing countries.

In Latin American countries, for example, there was a unique combination of early political independence and early integration into the international capitalist economy through the production and export of primary products. Their economies before the end of the 1930s were managed on the basis of "laissez-faire" and export-led growth. However, the ISI policy was adopted because of the negative consequences resulting from such integration, namely the severe impact of the Great 1930s Depression on those countries. Export revenues declined by 50-80 percent leading to a sharp decline in the GNP (Cammack, et al., 1993, p.75).

The depression and the negative impact of WW2 disturbed the import channels to the region from the industrial countries. ISI and the subsequent expansion of the public sector were a reaction aimed at reducing a vulnerable dependence on the international market. In other words, industrialization was seen as a way of survival in an unstable world.

In Africa and Asia, on the other hand, states were dependent on foreign exchange from agricultural and/or mineral exports. Industrialization was seen as a way of ending their economic dependency whether on cash crops, such as cocoa and coffee, or minerals such as copper,

bauxite and oil. The fluctuation in the prices of such primary products was another reason behind government policies of economic diversification through industrialization.

As a result the share of public enterprises in total output and investment increased in most developing countries but in varying proportions as, table (2.2) depicts.

Table 2.2
Public Enterprises Share of GDP and Investment
in Developing Countries Regions During
1976-1982

Indicator	PEs share (%)	Range (%)	Number of countries
<u>GDP</u>			
Africa	15	4-48	18
Asia	3	1-7	6
Latin America	12	2-28	8
<u>Investment (GDI or GFCF)</u>			
Africa	25	8-54	12
Asia	17	10-56	9
Latin America	19	7-47	17

Source: Swanson and Wolde-Semait (1989, p.8).

In the sample countries, it appears that African countries PEs represented the highest share in both output and investment.

However, the data itself does not explain the reasons behind the expansion of the PEs in developing countries. The reasons for the expansion of the public sector in Latin American countries were different from those in

Africa and Asia although both were motivated by the necessity of reducing their dependency on western industrialized countries.

2.3.5: Raising Revenue and the Control of Natural Resources

In countries with a limited tax base, there are few choices for the government regarding the collection of revenues sufficient to meet financial obligations on the one hand and achieve economic development on the other.

In Europe this argument led to the establishment of state monopolies in commodities such as salt and tobacco in order to tax consumption indirectly (Shackelton, 1986). In developing countries, state monopolies were required in a wider range of activities.

In addition to monopolizing industries such as tobacco, sugar, and alcoholic beverages, SOEs were established to control potentially profitable activities in the industrial sector, particularly in the extractive industries (e.g. petroleum refining, fertilizer). This is because per capita income in such countries is low and shrinks the revenue generated from the tax itself. On the other hand, developing countries are characterised by weak direct taxation systems. These require high transaction costs as well as an efficient institutional base. The cost of creating an efficient tax system was too high in comparison with the expected revenues. Governments, therefore, believed that SOEs would provide a successful alternative source of increased income, particularly in

the extractive sector, the main source of foreign exchange.

2.3.6: The Lack of Local Private Entrepreneurs

While in advanced capital countries private entrepreneurs were in sufficient supply, they were under-represented in developing countries. The latter lacked individuals who possessed "economic resources such as funds, risk absorption, managerial talent and (schumpeterian) entrepreneurship" (Trobat, 1983, p.31). As a result, political leadership took the initiative by converting the state into a big entrepreneur. In the case of some African countries, for example, the colonial experience interrupted the emergence of an indigenous private sector except for "petty traders subordinate to the big" European firms (Tignor, 1990, p.188).

Another factor was that foreign lenders and aid agencies were more confident and, as a result, more willing to lend and assist governments or their SOEs than private entrepreneurs (Herbst, 1990, p.951). This combined with the fact that most developing countries have had no local capital markets from which private entrepreneurs, assuming their existence, could generate the necessary capital for their investment (Aylen, 1988). So, in general terms, governments and their SOEs were the appropriate counterparts for foreign aid and the establishment of loans.

In Sub-Saharan Africa, for example, direct foreign loans to private enterprises at the end of 1984 represented only 0.6 percent while foreign loans to development finance institutions, which finance private and public investment, accounted for only 0.8 percent of the total loans to those countries (Marsden, 1990, p.19).

Even if the assumptions about the existence of entrepreneurs and the availability of funds did hold good, there was a problem in directing entrepreneurs towards large projects with high capital requirements and a long time span, such as petroleum refining, fertilizers, and cement (Balassa, 1987, p.6).

In a study conducted in 1988, Abu Shair found that the share of the private sector in Iraq had represented 56 percent of the GDP (without oil) in 1970. However, its share in the industrial sector to the total output of the private sector was only 12 percent. Meanwhile, in 1986, as the private sector's share in GDP declined sharply to 22 percent, the proportion of private industrial output to the total private sector output declined to 6 percent. This occurred because the private entrepreneur mentality is often directed towards investment in certain activities such as commerce and estate speculation rather than in manufacturing activities because of the highly risk-averse character of the private sector. Yet, even in the manufacturing sector, the Iraqi private industrial entrepreneurs had invested in food processing and other

light industries where there are only minor risks and very high short-term profits (Abu Shair, 1988, p.79).

The same argument could be used regarding entrepreneurs in other developing countries (Shirley, 1983, p.4).

Another argument presented in the context of private entrepreneurs is that, in some countries, such as in Africa, they were aliens and expatriates, which created a popular call for state control. Thus, people's attitudes revealed a strong mistrust of the private sector and with it the motivation of profit maximization in the market place. This derived from the historical links between such groups and colonialism which was associated with exploitation of the poor (Trebat, 1983, p.34) (Nellis, 1986, p.13) (Bulter, 1986, p.22) (Tignore, 1990) (Evans, 1990, p.103).

Thus, in developing countries there was a combination of factors regarding the lack of entrepreneurs parallel to those existing in advanced countries which led to the creation of the state as an entrepreneur investing in the economy through its SOEs.

2.3.7: Employment Generation

One of the main merits of SOEs in developing countries is that they employ a large number of educated people. Such an objective was categorised as urgent by the leaders of developing countries. In addition, it was supported by the high development theory which emphasised the importance of

generating wage labourers in order to generate demand in the economy and thus enable the economy to escape the no-industrialization trap (Romer, 1986).

However, it may be argued, as shown in table (2.1), that the capital intensity character of industrialization in developing countries does not support the argument of employment generation. Table (2.3) shows that the African public sector has employed more than half the workers in the formal sector. Meanwhile in the non-financial SOEs, it employed about 19 percent of the total. This could be because in African countries, where the capital intensity factor is lower than in other developing countries, the SOEs absorbed more than they did in other regions. By comparison, Asian SOEs absorb about 16 percent while in Latin American countries the absorption factor lies at about 6 percent.

Table 2.3
Public Sector Share in Non-agricultural Employment
in Comparative Perspective (%)*.

Region ===== levels of public sector	OECD countries	Africa	Asia	Latin America
Central government	8.7	30.4	13.9	20.7
State-local government	11.6	2.1	8.0	4.2
Non-financial SOEs	4.1	18.7	15.7	5.5
Total Public sector employment	24.2	54.4	36.0	27.4

Source: Heller and Tait (1983, p.7)

*The period 1979-1982.

A more recent figure for the African countries shows that SOEs absorbed between 25-30 percent of total employment in the formal sector during 1980-1986 (Swanson and Wolde-Semait, 1989, p.8). Even within the same regions countries varied sharply in their SOEs absorption of employment. In Somalia, for example, during 1980-1986, public enterprises absorbed only 5.3 percent of non-agricultural employment while in Guinea the share amounted to 68 percent (ibid, p.35).

Another indicator from the table is the employment in central government. While it constituted about 9 percent in OECD countries, it was more than 30 percent in Africa and about 21 percent in Latin America. Accordingly such a size and capacity of employment played an important role in providing a major source of income for the work force in developing countries.

However, the direct effect on employment is not analogous with the SOEs' total role in generating employment because investment in SOEs generates forward and backward linkages. That means the enhancement of opportunities for employment in other sectors of the economy.

Clements (1992) argued that

"the employment intensity of state activity must be assessed by measuring not only the number of jobs directly created by state firms but also by employment created for firms possess linkages with state firms" (emphasis added, Clements, 1992, p.51).

Direct and indirect employment generation, hence, constituted one of the SOEs' objectives in raising the living standard of the people by enhancing employment

opportunities in the modern sector. This goal has to be related to the incidence of poverty and low income levels characterising the economies of many developing countries.

2.3.8:Balanced Regional Development

One of the heritages of colonialism, familiar to most developing countries, particularly those colonized by Western powers, was the unbalanced development of the regions.

Japanese colonialism of Taiwan (1895- 1945) and Korea (1910-1948) led to the development of rural regions in those countries, particularly the development of a highly productive agricultural sector, and sufficient investment in the rural infrastructure (Henderson and Appelbaum, 1992, p.7).

In the case of Western colonization, however, the expansion of urban centres was the main feature. This was related to the economic gains generated from the extractive industries. An estimated \$6 bn of foreign investment (at 1978 prices) in Sub-Saharan Africa up to World War II was invested in mineral-related industries, particularly in Southern Africa. On the other hand, the colonial heritage contributed to agricultural underdevelopment after independence (Nafziger, 1990, p.143). For example in countries such as Ghana, Cote d'Ivoire, Nigeria and Uganda, there was a sharp contrast between the developed Southern Regions and the underdeveloped Northern Regions because the colonists had invested mainly in

exports (Cammack, et al., 1993, p.62).

In addition to the sharp contrasts between the regions, there were sharp contrasts between the very rich and the very poor as well as among sectors. There were imbalances in education, health and training, transportation and communications. A more balanced development was, therefore, one of the goals of SOEs. The establishment of new projects in underdeveloped regions was seen as a way of stimulating investment by the private as well as the public sector. Although such investment projects were not viable from the feasibility point of view, the state invested through its enterprises in order to achieve its goal.

2.3.9:Other Objectives

There were other objectives behind the creation of SOEs in different developing countries. In some countries, it was realised that private sector importers could exercise little power in negotiating the prices of their imports. The same situation prevailed in the case of exports where government power to sustain prices was greater than that of private exporters. The failure of the market to provide adequate information and subsequent equal bargaining powers led to the establishment of government trading agencies with the main aim of representing the interests of the private agents (Yaffey, 1992, p.13). Other goals such as the control of inflation through underpricing of SOEs' products, stabilization of the economy and equal

distribution of income and opportunities can all be included in the reasons and objectives for establishing SOEs.

Mulji (1990) argues that in the case of Indian SOEs

"there are at least 28 national objectives of state-owned enterprises are expected to pursue, ranging from building up surpluses and providing competition with the private sector to developing backward areas, developing indigenous technology, working as a model employer, and promotion a socially desirable pattern of consumption"(Mulji, 1990, p.143).

Such a wide range of objectives is quite different from those pursued in the private sector where the main goal is the maximization of profit.

2.3.10: Summary of Goals and Arguments

From the above discussion it is clear that there are differences in the origin, age and reasons behind the creation of SOEs in different developing countries. The objectives can be classified in various ways: micro-economic, macro-economic, short-term, long-term, commercial, non-commercial, strategic and secondary. Such goals may appear desirable on an individual basis, but when combined, they are often in conflict with one another. For example, inflation control seldom creates employment, underpricing policies cannot create profits, regional balances might be inconsistent with economic viability. From a technological dimension, a large scale plant may be an efficient project if it is to be established on purely economic criteria. However, when social objectives enter the viability equation, it may

fail to succeed economically.

On the other hand, the economic strategy itself may be different among different countries. In Latin America, for example, the main objective of ISI was the reduction of vulnerability to foreign economic shocks. In Asian countries, however, the main motive was to establish an industrial sector similar to the one existing in advanced countries (Banuri, 1991) although in India, the main reason was to achieve self-sufficiency through a pattern similar to the one adopted in the former USSR .

In other Asian and African countries the historical struggle against colonialism and the fight against dependency played a major part in the creation of SOEs. However, other reasons such as the increase in oil revenues and the prices of other minerals during the 1970s also contributed to the growth of the public sector.

In other words the political, social, historical and economic objectives behind the establishment of public enterprises were complex. However, economists tend to generalize the reasons for public or SOEs creation during the 1960s and 1970s. Gayle and Goodrich (1990) identified eight factors behind the creation of SOEs, namely the encouragement of a broad sense of responsibility towards the public interest, the creation of stable investment and employment patterns, the improvement of industrial relations, investment in sectors characterized by high risk and long time horizon, the replacement of private natural monopolies, direction and control of defence

related industries, stimulation of sectoral competition and information flow in order to achieve efficiency (as in the case of Singapore) and lastly as an instrument of decolonization. However, such generalizations have no validity when analyzing the case for successful privatization, because each country, and to some extent region, possessed different institutional factors.

The preceding analysis has attempted to make such a context explicit because it is important to present such a complex background for the purpose of examining the economic rationale for privatization. Thus, the question to be asked from the economic theory point of view is whether a change in the type of ownership from public to private would enhance the efficiency of the firm. Although this question may appear inconsistent with the background for the establishment of the public sector in developing countries in the first place (Zank, 1991, pp.165-166) (Prager, 1992, p.307), it denotes the major argument on which privatization stands. However, before introducing the theoretical arguments for public versus private ownership, it is important to question the performance of public enterprises.

2.4: Evidence on Public Enterprise Performance

The proponents of privatization often argue that the financial record of public enterprises worldwide is in itself evidence for the necessity of privatization.

Kikeri et al. (1992) said that, between 1989 and 1991, public enterprises financial losses as a percentage of GDP constituted 9 percent in Argentina, 8 percent in Yugoslavia, and on average more than 5 percent in some African countries. Also, 30 percent of SOEs in China incurred losses in 1991. As a result of the heavy losses of SOEs, government transfers (including subsidies) to these enterprises accounted for 4 percent of GNP in Turkey in 1990, and 9 percent of the GDP in Poland (Kikeri, et al, 1992, p.15).

Another study by Nellis (1986) asserted that in a sample of 12 West African countries, 62 percent of PEs showed net losses while 36 percent had negative net worth. However, the author argued that caution should be taken in interpreting financial data because of the differences in accounting and tax systems, government transfers and other factors such as depreciation, inflation and subsidies. Although the study refers to the constraints imposed by the African governments on pricing decisions, investment policies and other factors such as employment policies, all of which led to the bad financial results, successful cases in African public enterprises nevertheless still existed (Nellis, 1986, pp.25).

In a more recent study of public enterprises in Sub-Saharan Africa, Swanson and Wolde-Semait (1989) found that the net financial results of PEs in 13 out of 19 countries were negative while the remaining six were positive. They argued that the positive financial results were

attributable to the inclusion of mineral state enterprises into the final results. Estimates of profitability as a percentage of GDP for 22 countries range from -4.3 percent in the Gambia to 2.5 percent in Zaire (Swanson and Wolde-Semait, 1989, Table A.11, p.44). However, in the case of Gambia, the main losses occurred in one state enterprise (The Gambia Produce Marketing Board GPMB), the deficits from which accounted for 7 percent of GDP in 1983 (ibid, p.11). Another indicator is that the PEs' share of external debt in 31 African countries during the period 1980-1986 was 13.7 percent ranging from the highest in Cameroon (43%) to the lowest in Kenya (0.1 %) (calculated from ibid, Table A.9, p.42). This demonstrates that generalization about the financial performance of SOEs in a country cannot produce a clear explanation for the reasons behind bad performance.

Another study in Kenya, by Karanja (1989), found that in a sample of 25 state corporations, an investment of \$2.5 bn yielded a total surplus of \$24 mn or only a 1 percent rate of return. However the investment created employment totalling 79.5 thousand⁶. Moreover, during 1979-1984, the government received 6.5 percent as a dividend from their investment in state corporations (Karanja, 1989, p.272). Thus, what appears to be a modest financial performance should be explained within the context of the employment opportunities generated.

⁶The figures transferred to U.S. dollars using the exchange rate in IMF (1992).

In the case of Ghana, a cross-debts study on 18 SOEs (about 8 percent of all Ghana SOEs) in 1987 revealed that the cross-debts between SOEs totalled around \$58 mn in 1986 while their indebtedness to the government was around \$450 mn⁷ (as cited in Adda, 1989, p.306).

In the Egyptian non-financial SOEs, however, a study revealed the contrast between poor financial performance and positive economic performance. According to Ott (1991), the overall deficit of PEs in Egypt as a percentage of GDP rose from 3.9 percent in 1979 to 8.4 percent in 1983/1984 while the estimated rate of return on revalued assets was -5.7 percent (Ott, 1991, pp.204-206). On the other hand a study of 7 public firms in the Egyptian industrial sector showed that four of them had a negative rate of return in 1984/1985 while the indicators of total factor productivity (TFP) change, which could be a reliable measure of economic efficiency against that of financial efficiency, indicated a positive TFP change ranging from 0.5 to 11.1 during the period 1976-1984/1985 (calculated from *ibid*, Table 10.13, p.211). Thus, it appears that the poor financial performance of these enterprises did not reflect the positive economic efficiency trend symbolized by the TFP change.

There is also a number of studies which indicate the mixed stories of success and failure in some of the Western

⁷The figure are transferred to U.S. dollars employing the exchange rate in the IMF (1992).

Hemisphere countries.

In the case of Mexico, Weiss (1992) argued that, while in 1982 there were 1155 public enterprises, their total operating losses amounted to 2.1 percent of GDP. However, as the number of PEs was reduced to 280 public enterprises by 1990, the financial position of the remaining enterprises turned into surplus in 1987. However, the largest state oil company (PEMEX) remained in deficit. This also reflected the effect of exogenous variables such as oil prices which cannot be controlled within the enterprise. As a result the financial indicator is not analogous with economic efficiency.

In the Brazilian context, Guerra (1992) argued that the operational results of the public sector in Brazil have on average run at around -6 percent since the beginning of the 1980s.

In 1990, the 50 largest SOEs lost \$6.4 bn or 12 percent of their net worth and fifteen of the 20 largest deficit companies in the country were SOEs. On the other hand, nine of the largest profitable enterprises were SOEs. Such mixed results indicate the importance of studying SOEs on a case-by-case basis so as to understand the factors impeding the profitability of some enterprises against the success of others.

In the case of allocation efficiency, Guerra (1992, p.5) claimed that between 1975 and 1985 investment in the public sector (mainly SOEs) increased seven times faster

than in the private sector while the output ratio of public to private production did not even double. He commented that this indicated an inefficient allocation of resources. However, Schmitz and Hewitt (1991) argued in their study of government investment in the computer industry in Brazil that such a method of questioning the opportunity cost of investment may be misleading, the reason for this being that one of the main problems in the Brazilian economy during the 1970s and 1980s was that capital flowed into financial rather than manufacturing operations because profits in the former were easier and higher than in industry. On the other hand the Brazilian national computer industry, for example, was employing over 40 thousand people by 1987. Their social opportunity cost could be measured if there had been full employment in the economy, but that was not the case. Other benefits, such as cumulative learning, innovation, and adaptation to local demands and other positive externalities are not included in the account of financial performance. Thus, state efficiency in some enterprises might be increasing despite short-run costs. However, it is not possible to make generalizations applicable to all SOEs^a.

A study of Jamaican SOEs revealed that 21 public enterprises were unable to finance their operating expenditure, taxes and debt service in 1980/1981.

^aFor an analysis of the case of state ownership and privatization in Brazil and Mexico, read Schneider (1990)

However, by 1988/1989 they had succeeded in generating operating profits amounting to J\$ 752.6 mn and had financed about 90 percent of their capital expenditure. This demonstrates the possibility of transforming poorly performing SOEs into successful ones by adopting a package of reforms which increase accountability through efficient monitoring and control systems on the one hand, and, on the other hand increasing the prices of their products to competitive levels because they had often been denied the right to increase their prices (Schumacher and Hutchinson, 1991, pp.239-241). Nevertheless, examples of other Jamaican SOEs which are struggling with financial losses still exist, particularly in the utilities sector (ibid, p.242). Despite the success stories of some public enterprises, the authors of the above study believed that privatization is the main tool for enhancing the performance of SOEs. They concluded that "the Jamaican economy must pursue an aggressive privatization strategy if it is to be revitalized" (ibid, p.250).

Similar cases could be found in Peru. A study of the 1986 profitability of 56 SOEs revealed that 46 percent of them obtained no profits, 37.5 percent achieved profit rates of less than 15 percent, and 16.5 percent of the SOEs earned more than 20 percent profits (De Zevallos M., 1989, p.362). However, the author suggested privatization as the overall solution.

The above examples assert that the dangers of privatization derive from the sweeping belief in its merits. Privatization became a matter of belief rather than one option among others for the reform of public enterprises (Shackleton, 1986) (Starr, 1990). If the aim is to increase profitability per se there are many options for public enterprises in different developing countries to do so. For example Jones (1991, p.16) showed that in one case a large industrial public firm in South America moved from large losses to a significant profit within one year by changing the shape of the firm's accounts (i.e. debt and interest payment) rather than increasing efficiency.

In Asian countries, a study of Pakistan's 195 SOEs observed that the pre-tax return on capital in 1985/1986 for 37 percent of them was negative, for 32 percent average profits were between 0 and 15 percent, while the remaining 31 percent achieved pre-tax profits equal to or more than 15 percent (Bokhari, 1989, p.167). This could be another indication of mixed financial performance.

Another study from India reveals that public sector enterprises employed about 2.2 million people out of a total public work force of 16.8 million workers. In 1988, the share value of all Indian public sector enterprises was about \$22 billion while that of the private corporate sector was \$6.7 billion (Waterbury, 1990, p.295). Such figures reveal the domination of the public sector in the

Indian economy. However, against expectation, the rate of return on all investment in public enterprises in 1986 was 12.54 percent⁹. Even, after exclusion of the petroleum sector, the rate exceeded 7.5 percent. A comparison of this rate with comparable private sector enterprises revealed that the latter rate was 13.6 percent (Reddy, 1989, p.180). So, the difference between private and public investment rate of return was only one percent, an unexpected result considering the literature criticizing the public sector in India¹⁰. However, that does not mean that all public sector enterprises are financially viable.

In the case of Malaysia, there were more than 1000 SOEs in 1990. It was found that 60 percent of the SOEs had achieved profit during 1980-1988 while the remainder were unprofitable. Adam and his associates (1992, p.223) ranked Malaysian SOEs' general performance based on enterprise profitability relative to capitalization during the period 1980-1988. However, in 1988 16.7 percent of SOEs were "sick", 24.1 percent "weak", 14.4 percent "satisfactory" and 44.8 percent "good"¹¹.

⁹Public enterprises in this case include central, financial and non-financial enterprises, railways, power, irrigation, ports, telegraphs and telephones, road transports and several departmental enterprises.

¹⁰For a critical view of the Indian Public Enterprises see Lacey (1990).

¹¹Sick = Companies with negative shareholders fund.
Weak = Loss-making companies with shareholders funds <200% of paid-up capital.

In Sri Lanka the profits of commercial SOEs (about 145 at the end of 1989) fell from 5 percent in 1984 to -0.54 percent in 1988. Also, the return on assets declined from 2.21 percent in 1984 to -0.07 in 1988. The main problem for the SOEs in the manufacturing sub-sector is that of limited capacity utilization (only about 60 percent)(*ibid*, pp.305-306).

From the preceding case studies it can be seen that there are mixed stories of the success and failure of public enterprises in developing countries. Likewise, there is a misleading belief that inefficiency can be equated with financial losses.

More recent figures of the estimated losses of public enterprises in a number of countries or regions provided by UNDP (1993) show that the arguments for the privatization of SOEs can be divided between the belief in private sector technical and allocative efficiency superiority, irrespective of the institutional factor of a country, and the argument of the social opportunity cost of public enterprise losses (for example, in the context of education and health spending) which is within the dimension of allocative efficiency as well.

Leaving the argument of technical or X-efficiency to the next section, the question is: what is the relationship

Satisfactory = Shareholders funds <100%, but currently profitable.

Good = Shareholders funds >100% and profitable.

between allocative efficiency and profitability?

As illustrated in the analysis of "market failure", pareto efficiency (i.e. allocative efficiency) cannot equal profitability on all accounts. For example in decreasing cost industries a profit maximising producer has to produce an output less than the pareto-efficient level and sell at a price higher than that which the consumer is willing to pay (that is equal to the marginal cost of supplying the product). That is because, as the average cost is declining, pareto-efficiency (i.e. allocative efficient) will result in net losses on the part of producers since they have to produce more and charge less, which is against the rationality of profit maximization for a private producer. In this case, as we said earlier, the product could either be produced through the public sector or the private sector can produce the product with the government subsidising the losses occurred in order to achieve a more efficient allocation of resources. Thus, profitability is not a sufficient indicator of efficiency since both alternatives can lead to losses in order to achieve allocative efficiency.

The other side of the argument is that pareto-efficiency does not indicate any bias towards favouring private against public ownership. The important factor is competition in the market. Thus, as many services provided by the public sector imply a natural monopoly character, the monopoly rent after privatization will fall to private monopolists, which reduces consumer welfare and imposes

losses on society. This means that competition, rather than change in the geometry of ownership, is the critical factor.

On the other hand, the UNDP (1993) argument presented in table (2.4) is a rule of thumb. The assumption is that all financial losses in public enterprises will be directed towards education and health spending if they are to be eliminated. But since many of the losses occurred in the utility sectors, the question becomes: who will provide transportation, health, education and other services? If it is the public sector, then the losses will continue. On the other hand, if it is left to the private sector, then the allocation of resources toward such services will decline if not cease (the profit maximization constraint).

Table 2.4

The Social Opportunity Cost of Public Enterprises Losses (1988-1990).

Country or region	Estimated losses of PEs as % of GNP	Public education and health spending as % of GNP	Potential increase in education & health spending if PEs losses are eliminated %
Argentina	9	5.5	164
Poland	9	7.6	118
Bangladesh	3	3.1	97
Turkey	4	4.6	87
Egypt	3	11.0	27
Philippines	2	8.3	24
Sub-Saharan Africa	5	6.5	77

Source: UNDP (1993, Table no. 3.4, p.48).

A study conducted by the World Bank in 1993 revealed that cuts in spending occur "for important but politically less visible operations and maintenance (O&M)-such as providing drugs and supplies for health clinics and repairing roads" was one of the outcomes of the public spending adjustment programme imposed by the IMF and World Bank on 13 developing countries (Pradhan and Swaroop, 1993, p.29). Also, the squeezing of spending has affected investment in important infrastructural projects with high returns because such investment was seen as the "softer" option for the governments of developing countries (ibid, p.29).

Ramirez (1993) found that the austerity measures in Latin American countries during the 1980s led to a significant reduction in public spending on health and education. For example, in Brazil expenditure on health and education as a percentage of total public expenditure decreased from 12.4 percent in 1982 to 10.3 percent in 1989; in Argentina such expenditure declined from 17.2 percent in 1982 to 11.3 percent in 1989; in Mexico they deteriorated from 22.6 percent to only 8.5 percent between 1980 and 1988 while in Chile they decreased from 21.5 percent to 16 percent between 1982 and 1989 (ibid, p.1016).

If such losses, however, are a reflection of managerial inefficiency in public enterprises, then there is a need to understand the option for reform and/or privatization on a case-by-case basis rather than to implement the option of privatization in all cases.

This leads us to the important question of what is the economic rationale for privatization. Does ownership affect the productive or X-efficiency of an enterprise, and if the answer is yes, then why? But before answering such questions, it is important to provide an elementary analysis of the theory of the firm.

2.5: The Theory of the Firm

In the analysis of the neoclassical theory, there is no direct investigation of the internal factors affecting economic efficiency within the firm. That is because the neoclassical theory treats the firm as an impersonal and anonymous entity or a black box. It includes managers who are authorized to deal on the firm's behalf. The manager might be the owner and, if not, will be accountable to another person who will be the owner (entrepreneur). However, it is assumed that the owner is rational and will thus minimize costs in order to maximize profit (the residual). The major assumptions in this regard are that there is no separation between ownership and control and Zero transaction costs (costs of obtaining information about alternatives and of negotiating, policing, and enforcing contracts)¹². Thus, the economic behaviour and performance of different organizational forms, such as

¹²There are other assumptions such as Zero adjustment cost; owners fully allocate resources, which are privately held, for purely pecuniary motivation; the firm possesses only one plant and it produces one output; the entrepreneur's choice between income and leisure is independent of income (Zamagni, 1987, p.297).

that of "public" versus "private", have no place in neoclassical analysis. As Jensen and Meckling stated

"While the literature of economics is replete with references to the "theory of the firm", the material generally subsumed under that heading is not a theory of the firm but actually a theory of markets in which firms are important actors" (Jensen and Meckling, 1976, p.306).

In this case privatization has to be analyzed using other theoretical tools related to the literature on the theory of economic organization.

2.5.1: Theoretical Background for Existence of the Firm

In the traditional neoclassical analysis it was assumed that the entrepreneur is a coordinator or auctioneer in the market place. Thus, price mechanism will solve the problem of market transactions¹³. However, the question asked by Coase (1937) was what is the reason for the existence of firms if market transactions can solve the problem of coordination on the one hand and the maximization of profit on the other. In other words, the entrepreneur can make contracts with suppliers in the market place rather than choose to produce within the firm through internal contracts which include management, labour, input suppliers and financiers.

The answer given by Coase was that there are costs of

¹³Hodgson argued that as the entrepreneur, in the traditional neoclassical theory, is an auctioneer, this will imply his gathering, processing and communicating for a lot of information, particularly regarding the formation of prices. Consequently, such knowledge needs to be centralized which is "against the spirit of market system" (Hodgson, 1992, p.753). Thus, there is a contradiction within the neoclassical theory itself.

transactions, particularly those arising from imperfect information and uncertainty which can be eliminated through the hierarchical organization of the firm. He said

"Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-co-ordinator, who directs production" (Coase, 1937, p.388).

Nevertheless, Coase did not realize that there are transaction costs within firms. For Williamson (1973, 1975, 1979, 1981, 1985) the term transaction is derived from contractual agreement in addition to the one associated with market exchange¹⁴. There are ex ante costs which are related to the establishment of contracts and ex post costs which are related to administering, informing, monitoring, and enforcing the contractually agreed performance. Williamson, although he was more concerned with transaction costs in the contractual dimension, identified the factors which make market transactions less viable than hierarchies (firms). The question is what are these factors?

Generally, these factors are based on behavioural assumptions, but before presenting the factors, it is important to give the reasons behind the change in the traditional theory of the firm, particularly, those

¹⁴The notion of transaction which derived from exchange means the transfer of property rights to resources that involves no future responsibilities. This is mainly the approach of property rights theory (Alchian and Demsetz, 1972) (Furubotn and Pejovich, 1972).

related to the profit maximization assumption of the traditional neoclassical theory.

2.5.2: The Behavioural and Managerial Theories of the Firm

As firms developed in size and scope, conventional neoclassical theory was unable to explain the situation in the real world. In modern firms control has been given to managers while ownership has been spread among a large number of shareholders (owners). This new kind of owner has neither the power nor the interest in any single firm because the optimum portfolio of each investor tends to be diversified. As a result, risk bearing and management, the two traditionally combined functions of ownership have been separated. Berle and Means (1932) (as cited in De Alessi, 1973) were the first to suggest that the characteristics of the large cooperation tend to inhibit the efficient use of productive resources¹⁵. This is because managers' objectives may differ and even conflict with those of the owners.

This provided the ground for two theoretical attacks on the traditional neoclassical theory. The first was the behavioural theory which attacked the traditional objective function of profit maximization while the second (the managerial school) has maintained the principle of constrained maximization but observed the existence of other utility functions within the decision making

¹⁵That is because widely dispersed ownership is combined with the control of managers who have a relatively small ownership stake in the enterprise.

process.

In the behavioural theory it is argued that the main objective of the firm, as an organization rather than a firm working in an ideal world of perfect information, is "survival". Simon (1955, 1959, 1965) suggested that in the real world modern firms face a complex body of information as well as an uncertain environment. Therefore, it needs to be an organization rather than an individual entity. This organization is a complex of individuals and centers of powers. The objective of "survival" means that the firm's objectives will be to achieve satisfactory rather than maximum profit because people normally satisfy rather than maximize. Thus, he has referred to firm behaviour as a "satisficing behaviour".

Similarly Cyert and March (1963) rejected the firm's maximizing behaviour and argued that the firm is not a single decision entity, but rather a multi-decisional organization with a number of objectives. The reason for their belief in satisficing behaviour were the factor of imperfect information and the factor of limited managerial ability (organizational slack).

On the other hand, through the managerial theory several scholars have attacked the neoclassical assumption of profit maximization and introduced several utility functions for the managers of firms based on a separation of ownership and control. Subject to some profit

constraint, Baumol (1959) argued that a manager's objective is to maximize the firm's sales revenue in order to expand the firm. This leads to the consolidation of the managers power and position in their contractual arrangement. However, the profit constraint was assumed to be a device to finance the firm on the one hand and satisfy the owners or shareholders on the other. However, in a second contribution Baumol (1962) argued that the managers' utility function is to maximize the growth rate of sales revenue rather than the sales revenue itself. This utility function will depend not only on the expansion of the firm's productive capacity but also on its introduction of new policies to enhance future consumer demands (i.e. price reduction, new products).

In Marris's contribution (1964) managers maximize their utility function, which contains variables such as "security" and the "growth of the firm". The first variable (security) maintains the role and power of managers in cases of ownership change through merger or takeover while the second variable (growth of the firm) promotes their prestige and increases the possibility of obtaining higher salaries. In order to achieve such objectives, managers have to take into account the maintenance of higher valuation ration for the firm on the stock market¹⁶.

However, Williamson (1963) observed that there is a

¹⁶The valuation ratio is the ratio of the stock market value of the firm to its accounting or book value.

discretionary behaviour by managers resting at the centre of their utility function which is composed of salary, status, prestige and power. This managerial utility function derives from their "expense preferences". Yet, this discretionary behaviour which is financed from the firm's profit is still subject to the constraint of minimum profit because of the continuous threat of takeover.

In summary, the behavioural and managerial theories gave new understanding to the objectives of the firm which deviated from the neoclassical assumption of profit maximization and a result derived from the different and sometimes conflicting goals between managers' and owners' utility functions which are subject to constraints.

2.5.3: Markets vs. Firms

As the arguments build up, it is now established that there are factors behind the establishment of firms. That is to minimize the transaction costs of exchange in the market place as well as the establishment of different organizational forms in order to minimize the transaction costs within the organization. Williamson (1973, 1975, 1979, 1981, 1985) gave several factors which are based on a behavioural assumption regarding the existence of transaction costs within the market as well as within the firm. He said that

"...the interesting problems of economic organization are mainly to be explained by reference to the conjunction of a set of human attributes with a related set of (largely non-technological) transactional factors" (Williamson, 1973, p.316).

The main factors affecting the increase of transaction costs are; bounded rationality; opportunism and information impactedness.

Bounded rationality means that individuals have only limited information and limited capability to process it without error. This leads to incomplete information about market opportunities and limited capability of prediction derived from uncertainty regarding the reaction to future events¹⁷.

Opportunism costs derive from bounded rationality and self-interest behaviour. Because of information asymmetry individuals will act in an opportunistic manner to secure their interests when conflict arises between what they want and what they promise to conduct. Such costs might arise in the market when the number of bidders for a contract is small. Within the firm opportunistic behaviour might take a non-pecuniary direction if pecuniary gain is limited or cannot be obtained.

Information impactedness also derives from information asymmetry as some parties hold information which can be

¹⁷Sah (1991) argued that bounded rationality does not need to be defined because of limited individual capability to observe all the possible opportunities, but it has to be understood within the context of the other constraints. For example the cost of the time required to observe all the possibilities, the changes occurring in the circumstances of delayed decisions. In general there is a human fallibility which leads to such costs.

used in an opportunistic way so as to benefit them when contracting with other parties who lack such information. This imposes costs on the party lacking the information and may lead to unfavourable contract terms. Scitovsky (1990, p.137) argued that such an unequal distribution of knowledge derives from the division of labour which leads all individuals to possess specialized knowledge in their area of skill.

Thus, all the above factors lead to positive transaction costs which have to be minimized by internalizing them within the firm¹⁸. However, internalizing these costs does not mean their elimination and their existence introduces what is known as X-inefficiency.

2.6: The Theory of X-Efficiency

The behavioural context introduced by the preceding theories led Leibenstein (1966) to introduce the theory of "X-efficiency".

The degree of X-inefficiency is the degree to which actual output is less than the maximum output for a given input or the excess of actual over minimum costs for a given output.

The differences between the neoclassical theory and X-efficiency theory are summarized in table (2.5).

¹⁸In a more recent work Simon (1991) argued that the existence of the firm is derived from the necessity of "coordinating the activities of groups of individuals in ways that are not always easily achieved by markets" (Simon, 1991, p.38).

Table 2.5
The Differences Between X-Efficiency Theory and
the Neoclassical Theory

Components	X-Efficiency theory	Neoclassical theory
1. Psychology	Selective rationality	Maxim. or Minim.
2. Contract	Incomplete	Complete
3. Effort	Discretionary variable	Assumed given
4. Units	Individuals	Household & firms
5. Inert areas	Important variable	None
6. Agent-principal	Differential	Identity of interests

Source: Leibenstein (1978, p.129).

Leibenstein observed that the deviation of real effort given by the individual to the firm from the optimal one expected by the firm determines the degree of X-inefficiency. The other important factor is the amount of pressure operating on the effort variable. An individual whose behaviour is influenced by the context of selective rationality will not try to maximize profit or minimize cost because contracts are incomplete and there are differences of interest between the principals (owners) and agents (managers and workers). There is also discretion among firm members in their efforts to conduct the contractual activities and there are inert areas which are determined by the inertia costs of individual movement from one effort position to another. These inertia costs depend on individual personality (Leibenstein, 1978) and it is clear that the motivation of workers and the quality of managerial decisions are the major constraints on the productivity of modern firms (Leibenstein, 1978). Thus, it could be said that X-inefficiency results from the

existence of positive transaction costs which themselves stem from bounded rationality, opportunistic behaviour and information impactedness.

X-efficiency theory was criticised for its failure to emphasise the importance of different property rights structures, particularly since any decrease in the degree of X-inefficiency depends on monitoring and incentive factors, both dependent on introducing different structures of property rights¹⁹. However, we found that Leibenstein's (1989) observation on the importance of environmental pressure factors implies an indirect relationship with property rights structure. He argued that there are two notions of pressure, the first from below because of competition with other producers and the second from above, namely from the firm's owner or representative. Thus, "different institutional arrangements will involve different sources of pressure" (Leibenstein, 1989, p.1364). He suggested that the possibility of X-inefficiency is real in typical public enterprises because of the absence of pressure from either direction (above and below). He, therefore, suggested a number of options for the reform of public enterprises such as using a franchise approach in order to reduce costs.

However, it is still important to answer the question: what is the economic rationale behind privatization? Is

¹⁹For a methodological criticism of the theory see Stigler (1976) and De Alessi (1983).

ownership per se a major factor in enhancing X-efficiency or not?

2.7: The Economic Theory of Property Rights

The economic rationale for privatization within the context of ownership change is based on two fundamental theories; the first being the economic theory of property rights.

The main argument of this theory is that ownership matters. It is argued that the transfer of property rights from the public to the private sector will increase the efficiency of the enterprise, particularly that of X-efficiency.

This was first suggested by Adam Smith more than two centuries ago. Smith observed that the productivity of public land was only one quarter that of private land. The differences in productivity, according to Smith, were derived from the differences in the incentives available to employees under the two types of ownership. Public employees and managers are inefficient and negligent because they have no direct participation in the commercial outcome or the residual. Smith, therefore, suggested privatization as a solution.

Since Adam Smith the argument of private ownership superiority has moved forward. Because individual decision makers seek to maximize their interests subject to the constraints imposed by the organization (i.e. the

behavioural and managerial theories), it was realized that different structures of property rights would produce different levels of performance. This was particularly important because of the existence of positive transaction costs.

The firm is viewed, according to this theory, as a set of contracts among factors of production. In the classical firm the firm's owners or employers are the only ones with the right to design, negotiate and re-negotiate any input contracts. They also are the ones who hold the residual and have the right to sell their "central contractual residual status" (Alchain and Demsetz, 1972, p.734)²⁰. Thus, the owners' responsibility is to construct a contractual arrangement with other input owners (i.e., workers) so as to increase the firm's efficiency by reducing costs, particularly, those arising from shirking in team production because shirking results in an increase in the degree of X-inefficiency within the firm.

Thus, within the privatization debate, the comparison of efficiency with alternative property rights structures rests mainly on three factors, namely ownership specialization, risk bearing, and the transferability of ownership. The significance of these factors stems from their effect on the incentive (cost-reward) and monitoring

²⁰The concept of property rights in this school is different from the one regarding the institution of property rights within the economy. The latter is more associated with work of Douglass North (1981) (1986) (1989) (1991) (1993).

systems which result in different alignments of resources and different input-output mixes.

2.7.1:Ownership Specialization

Under private ownership people will choose to be owners of an organization if they possess a sufficient knowledge of its activities (Alchain, 1965, p.821). Such specialization will lead to a better decision making structure. It is better for decisions such as those on new investment or new technology or others related to the operation of the enterprise to be taken by specialized individuals who have an interest and stake in the enterprise as this will also increase their capacity to monitor management behaviour and decisions.

In the case of public ownership there is no such specialization because each member of the public has only a minute stake in the enterprise. Thus, even if it is assumed that individuals from the public have a stake in the efficiency of the enterprise, they will not possess a comparative advantage of ownership similar to that which exists under private ownership.

However, this argument may not constitute a decisive difference in the effects of ownership form. In most modern corporations shareholders are neither specialists nor knowledgeable in the activities of the organization; rather, the owners' objective may be to spread the risk of their investment by building up their investment

portfolios among different enterprises. In addition, the complex network of knowledge and information which characterises most modern corporations gives more advantage to the managers over the owners of the corporation (Fama and Jensen, 1983, p.308). However, Demsetz (1983, p.382) argued that a specialized ownership "creates pressure for less on-the-job consumption so long as monitoring cost is not a barrier to guaranteeing that what is promised by management is what is delivered".

2.7.2:Risk Bearing

One of the arguments of the property rights school is that the possession of private property is a voluntary decision based solely on the choice of an individual who then has to bear the risk of the decision. This risk bearing element derives from the status of the owner as residual claimant on the assets of the organization. This allows the individual as a shareholder or one of the owners of a corporation to participate in and contribute positively to decisions affecting the profitability and wealth of the corporation. By contrast, public ownership is not voluntary, thus individual members of the public have no risk bearing function in the context of individuality.

Hence, the most significant difference is that the incentive for the owners as risk bearers will be most apparent in the case of private ownership; consequently, the motivation for taking correct decisions, introducing an efficient system of incentives, and monitoring the

performance of the enterprise will be greater (Hanke, 1987).

In the words of Hanke and Walters (1990)

"The consequences of public ownership are predictable. The cost of shirking to a public bureaucrat is low. Consequently public managers and employees tend to engage in shirking activity and the acquisition of various perquisites that increase production costs. From a theoretical point of view, private and public managers and employees can be expected to behave in different ways. In consequence, private firms tend to be more efficient than public firms" (Hanke and Walters, 1990, p.98).

However, while the principle of commitment is a feature of private ownership, flexibility and self interest behaviour, according to the advocates of privatization, are the characteristics of public ownership.

Nevertheless, the separation of ownership and control in private corporations may also enhance the opportunistic behaviour of managers and employees. Thus, Williamson (1983, p.356) argued that "the condition of residual risk bearing is fully determinative of organization form". In this case the use of a U-form structure within a private organization may result in an inferior outcome to that of an organization using the M-form structure. This is because the decentralizing feature of the M-form structure offers more incentives to management and provides better control mechanisms than the first structure. Thus, risk bearing does not depend on the form of ownership per se, but on the organizational structure of the corporation as well.

An empirical study of nine British public enterprises

revealed that there is sometimes a positive effect from the introduction of the M-form structure (i.e. British Steel, Post Office) (Bishop and Thompson, 1992).

2.7.3: Transferability of Ownership

By and large, the most significant difference between public and private ownership lies in the factor of transferability of property rights. In public ownership the rights of the individual as shareholder of a public enterprise do not include the right of saleability or exchange of rights because this right is purely nominal (Alchain, 1965) (Millward and Parker, 1983). In other words, if members of the public are not satisfied with or do not approve of the performance of a public enterprise, they cannot sell their shares, which in itself denotes less pressure on the management of a public enterprise, which Leibenstein (1989) called pressure from the top or from above. Its absence in public ownership because of the vagueness of rights leads to a higher degree of X-inefficiency.

In contrast, the contestability of ownership represents one of the major monitoring devices for managers of a private corporation (Vining and Weimer, 1990). Where there is a high level of opportunism and shirking behaviour, the value of the enterprise's shares will fall on the stock market, on the one hand providing a signal to shareholders to sell their shares and on the other putting pressure on management to increase their efforts. Both outcomes will

lead to more X-efficiency.

Another dimension of this factor is the effect on investment. In private enterprises, investors will attempt to maximize the enterprise's present value by taking into account alternative future streams of benefit and costs and selecting the one which will maximize the present value of the enterprise (Demsetz, 1967).

On the contrary, De Alessi (1969) found that government decision makers, by discounting the financial stream of the proposed project, prefer to shift investment spending from the future to the present. In addition, they tend to modify the estimated cost-benefit data of the project towards their own preferences for certain alternatives, such as large and capital-intensive projects. Likewise, Niskanen (1971) (1973) in his bureaucracy model argued that bureaucrats prefer greater present budgets in order to increase their non-pecuniary consumption, such as their tenure period or prestige and power²¹. As government bureaus are the agents responsible for proposing new projects, they tend, in the absence of ownership contestability, to reflect their own interests. The result is a kind of sunk investment by politicians (Lott Jr., 1987). This explanation denotes one of the factors behind the technological behaviour of public enterprises in developing countries, that of high capital intensity

²¹The literature on bureaucratic behaviour has since developed in a different dimension, particularly through the public choice school and rent-seeking theory. For a detailed analysis, review chapter 1 of this thesis.

(James, 1989).

In contrast to the above argument, other scholars who have studied the relationship between politicians and voter/taxpayers, such as Crain and Zardkoohi (1978), observed that the non-transferability of property rights shifts the preferences of the public away from long-term investment projects towards labour-intensive and short-term projects which maximize their current benefits. This happens because the public discounts the benefits of that portion of output which occurs either after their death or a stay in the current political jurisdiction. Also, it maximizes the votes of politicians. The authors in a later study (1980) found that the property right structure provides an incentive mechanism, even within a monopoly structure, which minimizes the X-inefficiency of a private monopoly in comparison with a public monopoly.

However, Mayer (1987) observed that the association of private ownership with commitment to investment cannot be generalized in all circumstances. Imperfect competition in the capital market may discourage private investors from committing themselves to long-term projects while a stable bureaucracy with a good incentive and control system may be able to implement long-term investment in new projects.

In summary, the theory of property rights argues that a transfer of ownership from public to private will enhance the efficiency of the firm because of the better incentive systems and control mechanisms associated with private

ownership which derive from the benefits associated with residual claimants. Public assets are not owned, there are no clear rights for residual claimants and the exchange of rights does not exist. This lack of ownership contestability means that decisions formulated by public enterprise managers do not translate into a change in market prices and consequently there are no risk bearers of decisions.

It is the delegation of power from the public to politicians, and from the latter to ministers and then to directors and finally to managers which causes high attenuation of the property right structure. In addition, with no signalling device available to direct owners to influence and evaluate the decisions of the enterprise, the X-inefficiency will increase in public enterprises in comparison with private ones.

2.7.4: Elements of Critique

The main criticism of the theory of property rights is that it has established the differences between public and private ownership on the presumption that there is an existing and well defined system of property rights. This is true mainly in the advanced capitalist countries but such an assumption is not valid in either a large number of developing countries or the former socialist countries.

De Soto (1993, p.8) argues that in the advanced countries such as Britain, "the legal system has created property

rights that can be exchanged in an expanded market". On the other hand, such a system is not yet institutionalized in many developing countries. The comparison between public and private will, however, be meaningless without such an important ingredient.

Similarly, the work of Douglass North since the beginning of the 1980s has emphasised the necessity of establishing an efficient system of property rights (North, 1993).

Likewise, Brabant (1992, p.2) observes that property rights reform in the former socialist countries "is a necessary, if insufficient, condition for successfully moving toward market-based decision-making". Moreover, even when a comparison between public and private ownership, as in the case of property rights theory, may seem to be compatible with any case of comparison in the real world, such a context may vary widely between different countries. For example, Lipton and Sachs (1992) said that differences in the form of public ownership will in themselves determine the simplicity or complexity of any subsequent privatization.

In the case of British state enterprises the existence of an independent board of directors (appointed by the government) to run the enterprise, makes the transfer to private ownership an easy task because the system of corporation is well structured. Such a system is, however, absent from public enterprises in Eastern Europe and the existence of a workers' council, as the major controller of the firm, makes the transition to private ownership

more difficult, particularly in large enterprises. Thus, there is a difference between the legalization of private property and its institutionalization. The latter means providing the "social legitimacy" of property rights (Koslowski, 1992, p.684). In the former socialist countries, the uncertainty arising from such a lack of legitimacy, may hinder exchange and dissuade investment even when property rights become legal²². In the words of Koslowski:

"For the use of property rights to become a settled practice as in established market economies, a newly established system of property rights must become legitimate. If the rules regulating the recognition of property rights are not initially acceptable to the polity, the permanence of those property rights is questionable. Although exchange of such property rights is possible, reproduction of exchange on a routine basis is less likely" (Koslowski, 1992, p.684).

In the final analysis, the differences between the context in which property rights theory was developed, and the lack of a clear and institutionalized structure for such property rights in different developing countries may weaken the argument for privatization presented by this theory.

2.8: The Principal-Agent Theory

The most fundamental theory on which privatization has

²²For a more detailed analysis of the different dimensions of property rights in the socialist countries review Szakadat (1993).

been presented is the principal-agent theory²³. This theory focuses on the informational and incentive differences between private and public enterprises.

The agency problem arises from contracting with asymmetric information when the principals (owners) delegate other parties, the agents (managers), the right to act on their behalf, or as their representatives, in a particular set of decisions regarding the functioning of the organization. If both the principal and the agent are maximizers of their utilities, there will be a conflict of objectives. While the principals' aim is to induce their agents to act in their interests, achievement of this objective (i.e. maximizing wealth), will result in additional agency costs being imposed (Ross, 1973, p.134). The agency costs are the costs of writing and enforcing the contracts between the contractual parties. They include the costs of structuring, monitoring, and bonding a set of contracts with conflicting interests. They also include the value of output loss where the costs exceed the benefit yield from the full enforcement of contracts (Jensen and Meckling, 1976, p.308).

In other words, the principals will face a monitoring problem because of a lack of adequate information about

²³The essence of analysis for this theory is a mathematically oriented one. However, the intention is not to discuss the technicality of the approach but rather the main context on which the differences between private and public ownership are presented. For a sophisticated analysis of this literature within the context of privatization read Vickers and Yarrow (1988) and Bos (1991). For a general mathematical treatment, see Rees (1985a) and (1985b).

the efforts and behaviour of their agents (Strong and Waterson, 1987, pp.18-20).

In a simple relationship between one principal and one agent, the principal can reduce the agency costs by observing the change in the level of output. In this case, the optimal contract would be to compensate the agent in relation to the output level (Diamond and Verrecchia, 1982, pp.275-276). Because of the specialized nature of such a small firm, there would be no observability problem, or even if there were, it could be solved with minimum affect on the firm's efficiency (Fama and Jensen, 1983, p.307).

However, within the context of privatization, the comparison has to be shifted to the differences in the agency costs between large public and private corporations.

As the separation between owners (principals) and managers (agents) is a characteristic of such organizations, the agency costs will rise in both type of organizations. The ex ante costs arising from the "adverse selection" and ex post costs arising from "moral hazard" will increase the total agency costs derived from the problem of asymmetrical information and observability²⁴.

²⁴The "adverse selection" ex ante costs arise from the inability of one party, such as the principal, to distinguish between true and false information provided to them by different contractual parties, which may lead to choices that increase the costs on the principal. The "moral hazard" ex post costs arise in agreements in which at least one, the principal for example, relies on the behaviour of another party and information about that behaviour is costly.

As the number of shareholders (principals) is large in both public and private organizations, the difference between them lies in their ability to provide the optimal contractual agreement (the incentive constraint) and the monitoring devices (the information constraint).

In contractual agreements there is no decisive difference between public and private organizations if it is assumed that "bounded rationality" is a problem for the principals of both organizations. The difference between them lies in their ability to design contracts which induce the agents to act according to the principals' objectives. For example the use of pecuniary and non-pecuniary reward schemes can be found in both types of organization.

However, if the differences in the principals' objectives are taken into account, important differences can be assumed between the two. Shapiro and Willig (1990) argued that under public ownership, public enterprises are run by ministers or bureaucrats who are maximizers of their utility functions, a weighted average of social welfare and their personal objectives. These personal objectives satisfy the goals of "public management", such as large budgets, high wages and employment levels in particular enterprises or sectors, patronage, and the redistribution of income and wealth to favoured interest groups. It is sometimes argued that the result of these goals will be

Both terms are mainly used within the insurance industry (Williamson, 1985, p.47) (Holmstrom, 1979).

the absence of efficiency-promoting incentives, because this, even if sought by political decision makers, "is frequently a low-ranked priority" (Prager, 1992, p.307)²⁵. In contrast, the private owners of an enterprise are usually eager to pursue the goal of profit maximization, and efficiency as a means of achieving it, which is one component of the social welfare function. Others may be derived from the firm's activities such as the effect on consumer surplus and, for example, other distributional and non-distributional effects. Thus, in both cases, there is a divergence between the principals' objectives and social welfare (Shapiro and Willig, 1990) (Vickers and Yarrow, 1991).

However, what can decide the advantages of one form of enterprise against the other is the design and functioning of the political system versus the structure of the market. If there is an optimal political system, where managers cannot pursue their personal goals, then public enterprises are at an advantage in a non-competitive market structure. On the other hand, private enterprises will be at an advantage in a competitive market structure with an inefficient political system (Vickers and Yarrow, 1991). However, in reality both assumptions rarely exist,

²⁵Similar argument suggested by Bos and Peters (1991). In their words;

"The reward to the manager of a public firm is more differentiated than efficient. In the case of an unfavourable economic environment the reward is higher than efficient. In the case of a favourable environment the reward is higher than efficient"(Bos and Peters, 1991, p.48).

particularly in developing countries. Thus, the comparison will depend on the speciality of each case to determine the differences between the contractual arrangements in both forms of ownership. For example Bishop and Thompson (1992) found that the introduction of management remuneration schemes in some of the British public enterprises, such as the Post Office and British Steel, during the 1980s contributed significantly to an improvement in the performance of those enterprises without a change in the ownership structure.

The other most important factor which affects agency costs is the monitoring problem. This is based on the available information for each form of organization.

It is argued, that there are several control mechanisms, which can provide information and subsequently a disciplinary system to private enterprise managers.

The first is the Annual General Meeting (AGM) of the shareholders. Although shareholders delegate the power of decision making to the managers of the enterprise, they still retain the power to vote on important decisions. However, in large private corporations, the influence of internal managers is immense because of the wide range of information they hold which affects the decisions taken during the AGM (Demsetz, 1986). Jensen and Meckling (1976) argued that managerial share ownership reduces agency problems between internal managers and outside

shareholders leading to an increase in shareholders' wealth. The findings of Chang and Mayers (1992), however, contradicted the above suggestion from Jensen and Meckling. Even without such an arrangement, Millward and Parker (1983, p.215) said that during an AGM there are no strong tendencies for clashes between shareholders and managers.

However, in public enterprises, there is no meeting between the public and the managers. Ministers or representatives of other government agencies are the principals responsible for discussing the achievement of enterprise goals, which are often asymmetrical. With such features, the agency costs in such enterprises tend to be high.

The other monitoring device is change in the value of shares on the stock market. The difference, as mentioned earlier, between private and public ownership is the transferability or contestability of ownership. In private ownership, the changes in share prices provide a less costly mechanism for understanding the implications of internal decisions for current and future net cash flows. Thus, in the case of declining share prices, the owners will either change the managers or encourage them to correct their policies. However, where there is unresolved conflict, the shareholders will sell their shares as a reflection of their dissatisfaction with the managers' performance. This will put pressure on the managers to

increase their efforts.

A firm in continuing decline will be in danger of takeover by an other corporation, or of bankruptcy if the firm's assets fall below outstanding liabilities, or when, at least in the case of fallen share prices, the firm is unable to obtain access to additional capital (Vickers and Yarrow, 1988).

In public enterprises none of these devices exists to control the agents of an enterprise. This leads to an increase in their agency costs and increased inefficiency.

Nevertheless, Stiglitz (1985) argued that none of the above devices can succeed in disciplining private enterprise managers and thereby reducing the agency costs. He suggested that the three most important mechanisms are; control of the enterprise by the banks when they are major lenders, the concentration of equity ownership, and the factor of managerial reputation. Likewise, Jensen (1986) observed that enterprise debt can be beneficial in reducing agency costs.

Similarly, Fama (1980) discussed the effect of the managerial labour market, and two-way managerial monitoring inside the firm as mechanisms which reduce agency costs and ensure efficiency. However, Hirschey (1986) argued that internal managerial monitoring may depend on the structure of the organization itself. In other words, the hierarchical structure of management

within firms may preclude such internal monitoring.

In addition, the financial markets may not be the perfect mechanism by which shareholders can control their agents²⁶. Stiglitz (1985)(1993) argued that credit rationing may not provide a clear signal about the performance of managers in some enterprises. In other words, if the banks adopt a policy of credit rationing, they may refuse the finance of long-term projects and thus reduce the future performance of an enterprise.

Rees (1988) asserted that the problem of asymmetric information within public enterprises would lead to a greater provision of capital from the principals (planners or government) and less profit from the enterprise. This is because the principals cannot obtain full information about market and technology conditions and so are unable to give instructions to the agent about first-best level of price, output, labour and wage rates. This leads to an inefficient allocation of resources, particularly when there are no penalties in the public sector for unrealistic forecasting. Likewise, agency costs will be high in such enterprises because agents might give information about the level of production below the actual level, or the government may use past performance in

²⁶In a recent contribution Greenwald, Kohn and Stiglitz (1990) argued that financial market imperfection may negatively affect the productivity growth in large corporation.

setting future goals. Hence, the achievement of such targets will be rewarded while there is no incentive mechanism to induce the agents to perform up to their potential (Moore, 1981) (Sappington, 1991).

However, Vickers and Yarrow (1991) contended that loss-making public enterprises might face tightened state budgets which may limit managerial discretion. This would lead to a reduction in agency costs.

Moreover, following the Vining and Weimer (1990) model, the management of public enterprises may consider the value of their expertise and reputation as important factors in reducing agency costs.

External auditing may also play a role in reducing agency costs in both public and private enterprises (Watts and Zimmerman, 1983).

In summary, according to Shapiro and Willig (1990), what differentiates public vs. private regulated enterprises is the nature of private information. If private information about the agents in both enterprises cannot be revealed, there will be a major impact from privatizing public enterprises; however, if there is no hidden information, which diverges public and private interest, there will be no major impact from privatization. Similarly, Bos (1988) argued that it is the differences in incentive and information which count and not ownership. However, he believed that private ownership provides incentives for higher efficiency, while public ownership provides incentives for meeting social objectives.

On the other hand, as agency costs are major components in the total transaction costs, Sappington and Stiglitz (1987) argued that privatization will be beneficial through reducing the transaction costs derived from government intervention in enterprise decision-making.

However, we could not trace any major argument in the principal-agent literature that can stand without a challenge to the primacy of private over public ownership. Even the argument regarding the existence of the capital market as a signalling device might fail to stand in developing countries because most of them lack such capital markets. However, the threat of takeover and bankruptcy may put more pressure on private managers.

Nevertheless, on theoretical grounds, the differences between the two are not analogous with ownership, but rather information and incentives which are based on the main objectives of each organization. Simon (1991) summarised the above context in the following words:

"Large organizations, especially governmental ones, are often caricatured as "bureaucracies", but they are often highly effective systems, despite the fact that the profit motive can penetrate these vast structures only by indirect means" (Simon, 1991, p.43).

2.9: Conclusion

By examining the allocative role of the state, this chapter suggests that developing countries are not a homogenous group. Each region, and sometimes each country, has had different reasons for the creation and expansion of its public sector. Such conclusions have to be taken

into account when the proponents of privatization attempt to enforce privatization policies on some developing countries. That is to say, the argument of private versus public ownership seems to be, in general terms, irrelevant in a large number of developing countries because many of the reasons behind the creation and expansion of the public sector are still valid. Objectives such as the control of the commanding heights, the creation of high-tech industries, the control of natural resources, employment generation, balanced regional development and many others continue to be listed as high priorities in many developing countries. These are a translation to the theoretical context of public economics.

While the argument of private versus public ownership rests on cost-benefit analysis, it is suggested that profitability does not mean economically efficient. The empirical evidence from the three main regions of the developing countries revealed that public ownership is not synonymous with loss. On the other hand, the empirical evidence asserts that many loss-making public enterprises were economically efficient when parameters such as total factor productivity were employed in the analysis.

Arguments such as those based on opportunity costs were also found to be misleading because the losses themselves are related to the special character of the industry, or to the kind of policies enforced by the government on its enterprises in order to achieve specific goals (i.e.

learning, employment, subsidies). However, the chapter does not suggest that all public enterprises are efficient, only that it is necessary to study each case on its own in order to stand a better chance of reaching a more accurate conclusion about whether to privatize or not.

The theoretical presumption that private ownership is superior was, when investigated, also found to be misleading. While bounded rationality, opportunistic behaviour and information impactedness are found both in public and private organizations, the degree of transaction costs seems to depend on the structure of the organization rather than on the type of ownership per se. Although the economic theory of property rights presents several arguments in favour of private ownership, such a theory depends on the existence of stock markets where the shares can be transferred from one shareholder to another. In the majority of developing countries, however, such markets do not exist or, if they do, they lack the necessary institutions and codes which protect, enforce and legitimize property rights.

Within the context of principal-agent theory, the arguments have shown that incentive and information structures are the major factors which determine the level of agency costs and consequently X-efficiency. Better incentives and information are not characteristics of

private ownership alone. Factors such as tight government budgets, appropriate control mechanisms and efficient reward-penalty systems can be employed to the benefit of public enterprises as well. The existence of factors such as managerial expertise and reputation can minimize agency costs in both public and private enterprises.

However, all the above theories share the belief that competition in the market is the single most important factor in enhancing efficiency and reducing agency costs. Thus, it is not ownership, but market structure which determines the success or failure of privatization.

The question of efficiency at the enterprise level is whether efficiency will be improved under private ownership. In such a context the investigation of the competitiveness of the firm will play a more important role in the analysis of efficiency than the simple test of profitability. However, even if there are efficiency gains from divestiture, these should be compared with the transaction costs of the divestiture itself.

On the macro level the reasons for privatization in developing countries might not be related to the question of efficiency alone but to other factors. However, this will be the task of the next chapter which will review the empirical evidence regarding the different dimensions of privatization in developing countries.

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Chapter 3

Review of the Empirical Evidence on Privatization in Developing Countries

- 3.1: Introduction**
- 3.2: Efficiency Comparison**
- 3.3: The Factors Determining Private Investment**
- 3.4: The Relationship Between Government Size
and Economic Growth**
- 3.5: The Relationship Between Public Enterprises
and Budgetary Deficit**
- 3.6: The Relationship Between Privatization
and Development**
- 3.7: The Reasons Behind Privatization**
- 3.8: The Relationship Between Privatization and
the Distribution of Gains and Losses**
- 3.9: Conclusion**

3.1: Introduction

This thesis provides three tables on the number of SOEs and detailed privatization experience in developing countries.

Table 3.1
The Number of SOEs (1986) and Cases of Privatization (1987) in the Low-income Countries.

Country	No. of non-financial SOEs	No. of financial SOEs	Total number of SOEs	No. of privatisation cases underway	No. of planned privatization cases	No. of completed privatization cases
1. Nepal	37	9	46	...	6	...
2. Bangladesh	34	16	50	...	7	8
3. Malawi	25	1	26	1	...	1
4. Zaire	40	5	45	1	...	9
5. Mali	28	7	35	1	6	5
6. Uganda	67	7	74	...	5	7
7. Tanzania	204	8	212	n.a.	n.a.	n.a.
8. Togo	47	8	55	4	22	16
9. Niger	23	10	33	10	9	14
10. Benin	52	7	59	2	13	...
11. Somalia	51	6	57	...	...	2
12. Cent. African Rep.	15	5	20	...	...	1
13. Rwanda	29	8	37	...	...	1
14. China	n.a.	n.a.	n.a.	...	6	...
15. Kenya	110	22	132	1	...	2
16. Zambia	304	12	316	...	...	6
17. Sierra Leone	22	7	29	...	...	2
18. Pakistan	88	25	113	10	3	1
19. Ghana	50	11	61	31	...	7
20. Sri Lanka	110	16	126	...	6	12
21. Mauritania	28	12	40	3	...	5
22. Senegal	47	10	57	2	33	6
23. Guinea	184	7	191	8	...	39
Total	1595	219	1814	74	116	144

Sources: The figures are calculated by the researcher.

(1) SOEs figures are calculated employing the data in IMF (1987) [Supplement on public sector institutions].

(2) Privatization figures are calculated by employing the data in Candoy-Sekse (1988).

Note: Privatization cases may include privatized branches of the same SOE.

Table 3.2
The Number of SOEs (1986) and Cases of Privatization
(1987) in the Lower Middle-income Countries.

Country	No. of non-financial SOEs	No. of financial SOEs	Total no. of SOEs	No. of privatization cases underway	No. of planned privatization cases	No. of completed privatization cases
1.Liberia	16	5	21	1	10	2
2.Indonesia	155	109	264	...	1	3
3.Philippines	41	13	54	...	...	5
4.Morocco	73	11	84	...	...	11
5.Bolivia	35	16	51	1	...	1
6.Nigeria	83	31	114	...	98	...
7.Dominican Rep.	8	4	12	1	2	1
8.Papua New Guinea	16	4	20	8	5	1
9.Cote d'Ivoire	57	6	63	...	...	36
10.Honduras	11	6	17	...	14	2
11.Egypt	468	31	499	...	...	2
12.Thailand	497	131	628	2	5	2
13.Jamaica	117	18	135	4	3	34
14.Cameroon	58	9	67	...	1	5
15.Turkey	31	10	41	7	...	2
16.Tunisia	106	19	125	...	...	8
17.Colombia	345	67	412	...	...	1
18.Chile	21	7	28	4	4	40
19.Costa Rica	28	16	44	5	1	1
20.Jordan	19	9	28	...	4	...
Total	285	522	2707	33	148	157

Source: The figures are calculated by the researcher.
(1) SOEs figures are calculated by employing the data in IMF (1987) [Supplement on public sector institutions].

(2) Privatization figures are calculated by employing the data in Candoy-Sekse(1988).

Note: Privatization cases may include privatized branches of the same SOE.

Table 3.3
The Number of SOEs (1986) and Cases of Privatization
(1987) in the Upper Middle-income Countries.

Country	No. of non-financial SOEs	No. of financial SOEs	Total No. of SOEs	No. of privatization cases underway	No. of planned privatization cases	No. of completed privatization cases
1. Brazil	561	14	575	53 a	...	28
2. Malaysia	73	10	83	3	21	10
3. Mexico	243	75	318	5	4	10
4. Portugal	244	36	280	1	12	...
5. Panama	218	5	223	1	3	5
6. Argentina	233	42	275	14	7	3
7. Korea, Rep.	144	10	154	...	9	7
8. Venezuela	66	27	93	1	4	...
9. Gabon	33	9	42	...	...	3
10. Oman	21	4	25	...	...	4
11. Trinidad and Tobago	58	9	67	...	4	...
12. Israel	166	15	181	1	2	1
13. Singapore	15	8	23	3	36	15
14. Iraq (b)	267	9	276	1	1	3
Total	2342	273	2615	30	103	90

Source: The figures are calculated by the researcher.

(1) SOEs figures are calculated by employing the data in IMF (1987) [Supplement on public sector institutions].

(2) Privatization figures are calculated by employing the data in Candoy-Sekse (1988).

Note: Privatization cases may include privatized branches of the same SOE.

(a) This number is the sum of both privatization cases, both underway and planned.

(b) The number of SOEs in Iraq as cited in Abu Shair (1988).

The main purpose of tables (3.1), (3.2), and (3.3) is to provide a general statistical overview of the scope of privatization.

We now turn to the empirical work conducted by different scholars regarding privatization in developing countries. They are rarely brought together in the literature, hence this review.

The review is not restricted to covering the efficiency part but will encompass a wider scope of issues related to the analysis of privatization in developing countries.

This literature review concentrates first on empirical studies at the microeconomic level. It compares efficiency between public enterprises and between public and private enterprises. The major question is; is there solid empirical evidence which supports the belief in the superiority of private over public ownership?

The remaining empirical studies are concerned with the macroeconomic level, and deal with;

ii) The factors determining private investment in developing countries and question in particular the effect of public investment on private sector investment.

iii) Study the relationship between government intervention (and/or government size) and economic growth.

Is there conclusive evidence of an adverse relationship between government size and economic growth?

v) Investigate the impact of public enterprises on budgetary deficits in developing countries.

vi) Study the correlation between privatization and development in its wider definition (including the human development index). Is there a positive relation between privatization and development?

vii) To find the reasons for privatization in developing countries. Is privatization domestically motivated by the desire for efficiency or is it imposed by external factors?

viii) There are also the distributional consequences of privatization. Who are the major winners and the losers from such a policy?

3.2: Efficiency Comparison

There are about 15 empirical studies into this question. The first study is by Aylen (1988). He compared two publicly owned steel enterprises, one (POSCO) in South Korea and its counterpart (SAIL) in India. He found that the labour productivity per worker in (SAIL) was only one-tenth that in its counterpart. He concluded that it is not ownership but rather market environment, firm organization

and managerial incentives which determine a firm's performance.

Millward (1987) studied the comparative performance of public and private enterprises in less developed countries (LDCs) in terms of productivity and cost effectiveness over the period 1976-1986. He concluded that there was no statistically significant evidence that private enterprises in LDCs which function at the same scale of operation as their counterparts in the public sector are technically more efficient.

Levy (1981) investigating private and public enterprises in three industries in Iraq found that public firms are more technically efficient while private industries were more allocatively efficient than their counterparts¹. The author concluded that there is a significant possibility for economic growth if an increase of allocative efficiency in the public sector is accompanied by an increased of technical efficiency in private industry. Likewise, Abu Shair (1988) found that the productivity of labour in both private and public industrial enterprises increased in Iraq during the period 1970-1985. However, the annual growth for labour productivity in the private

¹A firm is technically efficient when it produces a higher level of output with the same sets of inputs while it is allocatively efficient if it equates the value of the marginal product of each variable input with its opportunity cost (Levy, 1981, pp.236-237). For a further analysis of efficiency read the preceding chapter.

sector was 6.7 percent while in the public industrial sector it was only 5.3 percent (Abu Shair, 1988, p.22).

Ilokwu (1991) carried out a comparative analysis of 24 enterprises in Nigeria (12 SOEs and 12 private enterprises) across four industries over the period 1980-1989 and reached the conclusion that public enterprises produced a lower performance (return on investment) and were less efficient (annual turnover ratios). Across the four industries (airline, insurance, banking and manufacturing), public enterprises were 1.9 percentage points less than private enterprises in the return on investment ratio and 12.2 percentage points lower in the annual turnover ratios. However, public insurance companies outperformed their counterparts in the private sector.

Perera (1991) compared the performance of the public and private bus transport systems in Sri Lanka. The study revealed that the average operating cost of the private bus sector was 2.5 times lower than in the public transport system. Likewise, the productivity ratios for cost efficiency asserted the superiority of the private bus system. The same results were found when comparing labour efficiency between the two types of ownership.

The other empirical work is by Ruangrong (1992) who examined the efficiency parameters of the monopoly state-

owned electric utility in Thailand (EGAT) and revealed an efficient performance. Productivity growth rose around 1.15 percent annually during the study period. There was also no divergence in total factor productivity (TFP) growth between EGAT and the private industrial manufacturing sector². The scholar concluded that there was no justification for the privatization of EGAT because it was fulfilling its objective of cost minimization.

A study by Balassa in 1987 reviewed eight previous studies which had compared the relative efficiency of public and private enterprises in developing countries. The author, one of the strongest advocates of privatization, concluded that private enterprises are more efficient than their counterparts in the public sector and that therefore privatization will enhance efficiency. However, Millward (1987) who made use of a number of the same studies reviewed by Balassa, such as Tyler (1979), Hill (1982), Gupta (1982) [(cited in both Balassa (1987) and Millward (1987))] reached a different conclusion regarding the differences between the efficiency of private and public enterprises.

Potts (1992) in a paper presented at an international conference on post privatization policy, held at Bradford University, claimed that there was no conclusive empirical

² TFP = (Weighted index of physical quantities of output) / (Total expenditure on inputs / Weighted index of input prices').

evidence to suggest that "the economic performance of the public sector estates (agriculture) in Tanzania has been any worse than that of the private sector in general" (emphasis added, Potts, 1992, p.13). He observed that during the period 1970-1985, the production performance of estates deteriorated significantly in both the private and public sectors while those owned by foreign companies performed better than the national ones. The reasons behind the deterioration lay outside the ownership effect with factors such as institutional change, access to foreign exchange, the exchange rate effects, taxation policies, and the general economic environment playing a major role in determining overall performance. Potts concluded that privatization would not be able to solve problems of productivity without the injection of new external resources into the agricultural estates. In his words

"rehabilitation is far more likely to succeed if it has the backing of the resources of a foreign investor. Simply privatising without injecting new external resources does not necessarily solve anything. There is a strong positive relationship between the level of external resources introduced and the production response" (Potts, 1992, pp.14-15).

Dollar (1990), in an econometric analysis, studied the change in TFP growth and the change in the allocative efficiency of 20 Chinese industrial SOEs³. In comparison with the pre-reform period (before 1978) these enterprises experienced in 1982 a rapid growth in TFP as well as an

³For the calculation of TFP, see footnote no.2.

improvement in allocative efficiency. Efficiency gains also showed a positive correlation with the share of enterprise profit distributed to workers and managers. Thus, a reform of the incentive system rather than a change in ownership played a significant role in enhancing the efficiency of these enterprises. Within the same context, a study by Park (1987) showed that changing the system for evaluating the performance of public enterprises in South Korea played a major role in enhancing the performance of public managers. The revision not only adjusted the mechanism of accountability but also provided better guidelines for rewarding the efforts of management and employees.

Cakmak and Zaim (1992) for their part studied the comparative efficiency of public, private and mixed enterprises in the Turkish cement industry. The examination of the 41 cement plants comprising 17 SOEs, 18 private enterprises, and 6 mixed enterprises in 1990, revealed that the ownership factor had no effect on the economic efficiency of the different plants. Rather was market structure or competition the driving force behind improvements in the productive efficiency of the 41 plants. Efficiency gains from divestiture policies, the scholars concluded, are likely to be negligible unless accompanied by enhanced competition in the market place.

Boardman and Vining (1989) investigated the relationship

between type of ownership and economic performance for the 489 largest manufacturing and mining corporations outside the United States operating in a competitive environment. The sample consisted of 409 private companies (PCs), 23 mixed enterprises (MEs) and 57 SOEs. It was found that the average return on equity was only positive (4.3 percent) in the private companies. Meanwhile the rate of return in PCs was 14.5 percent higher than that in SOEs and 18.4 percent higher than in MEs.

The efficiency indicator of average sales per asset showed PCs to have the highest ratio; however, in terms of sales per employee, MEs outperformed SOEs and PCs. The conclusion of the study was that partial privatization is worse than either complete privatization or complete state ownership.

Weiss (1992) examined the effect of ownership on performance for a sample comprised of around 200 industrial enterprises in Mexico. Three measures of firm performance -sales, sales per worker, and sales per total assets- were estimated for these enterprises for the period 1985-1990. After constructing a cross-sectional regression model to explain the changes in the performance indicators brought about by variables reflecting scale, industrial structure, general industry trends (measured by changes in nominal protection) and ownership, the scholar concluded that there was no relationship between economic efficiency and ownership type. According to Weiss's

estimates, firm's performance was strongly influenced by industry-level trends, with some influence from market structure, as measured by concentration and protection. However, foreign companies, in the same industry, were more efficient than national firms after size differences were taken into account. The empirical study concluded that there was no support for the view that state ownership per se implies a poor performance. The scholar emphasized, however, that such a finding may have been due to the privatization of many poorly performing SOEs in Mexico before 1985. Nevertheless, he stressed that factors such as economies of scale, market structure and industry trends may be more important in explaining a firm's performance than ownership type.

A number of financial ratios taken from a large sample of public and private enterprises in Chile during the period 1980-1987 were studied by Hachette and Luders (1992) [as cited in Luders (1993, p.114)]. They concluded that private enterprises as a group were slightly more efficient than SOEs. The reasons behind this efficiency were a minimum of political interference in SOE operations during the period and the positive effect of a hard budget on the opportunistic behaviour of SOE managers. The first factor reduced transaction costs while the second reduced agency costs.

However, by employing a different methodology to analyze efficiency Hachette, Luders, Tagle and others claimed that

in five out of six large privatized enterprises, internal efficiency had increased as a result of privatization (Luders, 1993, p.114).

It is clear, therefore, that empirical work at the microlevel in developing countries has produced no conclusive evidence to confirm the superior efficiency of private enterprises over their counterparts in the public sector. Generalizations derived from property right and principal-agent theories about the effects of ownership on efficiency are not evidenced in all the empirical work. On the contrary, factors such as organizational and market structure, enterprise size and other institutional factors have been found to play an important role in determining the efficiency of an enterprise whether it is in the public or the private domain. It is also important to note that the different methodologies regarding the calculation of efficiency employed in the various empirical studies can in themselves lead to different conclusions being drawn from similar sets of data.

3.3: The Factors Determining Private Investment

This group of studies concentrates on the factors which determine private investment in LDCs, in particular, the hypothesis of public investment "crowding-out" private investment.

An econometric study by Greene and Villanueva (1991)

analyzed the economic factors determining the average levels of private investment in 23 developing countries over the period 1975-1987. The econometric evidence indicated that the rate of private investment was positively related to the rate of public sector investment. The study found no statistical evidence to support the argument of crowding-out and the researchers made reference to the importance of categorizing public investment into two kinds, long-term investment (in infrastructure) and short-term investment (other activities) in order to investigate the validity of the crowding-out hypothesis.

The International Finance Corporation (IFC) of the World Bank undertook a study of private investment in 30 developing countries during the period 1970-1988 (Madarassy, 1990). In order to examine the "crowding-out" hypothesis the IFC looked at 31 episodes when public investment was increased by more than half a percent annually over a 3-year moving average period. In nearly 55 percent of the cases private investment (as a percentage of GDP) also grew while in the remaining cases it declined. Thus, there is no conclusive evidence either that in developing countries public investments support private investment or that they compete with it.

Blejer and Khan (1984) examined the impact of government economic policy on private investment in a sample of 24

developing countries over the period 1971-1979 and concluded that there was a quantitatively important role for public investment in the process of private capital formation. However, although the researchers advocated the "crowding-out" hypothesis, their study was not able to provide any powerful evidence for it.

Rodrik (1991) investigated the relationship between policy uncertainty and private investment in developing countries and established that the uncertainty deriving from reform policies in developing countries may have a more harmful effect on private investment. After developing a model to measure the effect of uncertainty on private investment he reviewed more than 10 empirical studies which supported his hypothesis and concluded that economic liberalization and "getting the price right" might have a negligible effect on private investment in developing countries when compared with policy stability and continuity.

A study by Pradhan, Ratha and Sarma (1990) dealt with the relationship between public and private investment in India under different modes of allocation and financing public investments. The research group used an 18 sector computable general equilibrium model and demonstrated that, although public investment crowds-out private investment the economy would be better off with increased public investment in terms of its effect on total investment, growth and distribution of income. As a result

they took the view that the "crowding-out hypothesis, when considered in a wider perspective, need not be undesirable" (Pradhan, et al., 1990, p.115).

In another empirical study of Latin American countries Cardoso (1993) investigated the issue of private investment from different perspectives. In the relationship between public and private investment the scholar drew attention to the argument of the over-extended public sector and its poor performance. However, he stated that

"even though the performance of the public sector has been strongly criticized, the empirical evidence shows that there is an important complementarity between public and private investment" (Cardoso, 1993, p.842).

In his regression model for the relationship between public and private investment in six countries he estimated that a one-percentage point increase in the share of public investment in GDP increases the share of private investment in GDP by more than half a percentage point.

Nevertheless, he also observed that the crowding-out hypothesis may hold if there is an increase in budget deficits since government borrowing from the local credit market is likely to crowd-out private investment because of the subsequent increase in interest rates and the reduction in the availability of credit to the private sector.

In a similar econometric study of the factors determining private investment in 15 developing countries Serven (1993) investigated the effect on the private investment/GDP ratio of a one point increase in five variables; public investment/GDP, foreign debt/GDP, real GDP growth, inflation instability, and the real exchange rate instability. The regression results indicated that the largest effect on private investment corresponded to the public investment ratio. An increase in the ratio of public investment/GDP of one percentage point raises the private investment ratio by 0.257 percent. More significantly, a reduction in the public investment ratio contributed to a deterioration in the private investment ratio of about half a percent.

The main conclusion of the researcher is that

"even if austerity and liberalization consolidate, the market equilibrium may not bring renewed investment and growth. In these cases government action is needed in ways that revive "animal spirits" and get private investment underway. The provision of public infrastructure (in particular given the compression of public investment in the eighties in many LDCs) may play an important role here" (Serven, 1993, p.137).

Although there is a sweeping belief that there is an over extended public sector or investment by this sector in developing countries, a calculation of the trends in private investment provided by Pfeffermann and Madarassy (1992) reveals a different conclusion. An analysis of the data for 47 developing countries indicates that during the period 1981-1985 private investment, as a share of total

investment, amounted to about 56 percent while during the period 1986-1991 it increased to about 59 percent⁴. However, there is a wide gap between different developing regions. For example, private investment in eight East Asian countries was on average about 68 percent of total investment during the period 1980-1991 whereas in 18 Latin American countries it stood at about 60 percent for the same period. In other words, despite the weight of private investment in the Latin American countries their economic performance was still below that achieved in the East Asian countries. The reasons for good or bad economic efficiency shift therefore from the traditional vision of the effect of ownership geometry to other institutional factors differentiating the two regions which have not been taken into account by the advocates of privatization.

3.4: The Relationship Between Government Size and Economic Growth

Seven empirical studies are available which have examined the relationship between government intervention and/or government size on the economic growth of developing countries.

Singh (1985) (as cited in Schackelton, 1986, p.434) carried out an econometric analysis of 73 developing countries aiming to assess the impact of government

⁴All figures have been calculated by the researcher employing the data published by Pfeffermann and Madarassy (1992).

intervention (regulatory role of the state, its level of nationalization on a numerical scale) on economic growth. The study pointed out the significant negative effect of such intervention on a country's rate of economic growth (other factors constant).

Landau (1983) took a sample of 104 developed and LDCs (including 8 major oil exporting countries) over the period 1961-1976 and found that the size of government (share of government consumption expenditure in GDP) was negatively correlated to the rate of growth in per capita GDP. He confirmed that the relationship was negative and statistically significant for both lower and higher income countries.

Another study by Nunnenkump (1986) assessed the effect of public enterprises (their share in output and investment) on economic performance (real growth in GDP, gross fixed investment, industrialization level and the growth of employment) but was unable to detect any statistically significant cross-country relationships between the role of public enterprises and general economic performance with the exception of the industrialization level which showed itself to be positive.

An econometric study by Scully (1989) covered 115 market economies including 93 LDCs in the period 1960-1980. The analysis indicated that the size of the state (measured by

government expenditure as a fraction of national output) was negatively correlated with economic growth (growth rate of real GDP) with each one percentage increase in the size of government in 1960 or during the 20-year period of study reducing the growth rate by roughly 0.1 percent. The same negative trend was found in the size of government and economic efficiency (technical or production efficiency).

Khan and Reinhart (1990) separated the effects of private and public investment on economic growth in a sample of 24 LDCs over the period 1970-1979. After developing a simple growth model that allowed private and public investment to exercise differential effects on output, the study found that private investment plays a more important role than public investment in increasing long-term economic growth. Public investment appeared to have no statistically significant effect on growth. Nevertheless, the researchers indicated that their conclusion was related only to the direct effects of public investment stating that "it is quite possible that public investment has positive indirect effects on growth" (Khan and Reinhart, 1990, p.25). In other words government investment in infrastructure and human capital may have a complementary effect on long-term investment in the private sector as well as a positive effect on the long-term growth of the economy. The policy implications of their results were as they claimed

"governments should aim at creating conditions which make private investment attractive. These conditions can range from the most general - establishing a stable macroeconomic environment, provision of adequate legal and institutional arrangements for the protection of private property - to more specific ones, such as adequate access to credit and to imported inputs by private investors" (ibid, p.25).

Kirkpatrick (1986) looked at a sample of 23 LDCs and established a negative, but statistically insignificant relationship, between the share of public enterprise output in GDP and the growth in income in these countries during the 1970s. Cook and Kirkpatrick (1988) pointed out that the argument of an "over-extended" public sector in LDCs is empirically unproven and the evidence of a negative relationship between the size of public sector and macroeconomic performance is inconclusive.

Finally Ram (1986) analyzed the effect of government size on economic growth for 115 market economies over the period 1960-1980 and found a positive correlation between the two variables. Productivity in the government sector, moreover, appeared to be higher when compared with the private sector, particularly during the 1960s.

The empirical evidence for the relationship between government size and economic growth, provided by the empirical studies above is insufficient to support a rejection of government intervention and investment in the economy. The significance of these studies, however,

derives from their recommendation for a higher quality government intervention, and the mobilization of public resources for selective activities particularly where public investment can "crowd-in" private investment.

3.5: The Relationship Between Public Enterprises and Budgetary Deficit

One of the main arguments for privatizing public enterprises in developing countries is their negative impact on the budgetary balance.

Short (1984), in his international statistical comparison, found among different macroeconomic indicators that the overall deficit of public enterprises in the mid-1970s in a sample of 12 industrial countries was only 1.7 percent of GDP as opposed to 3.9 percent of GDP in a sample of 25 LDCs. After the deduction of government transfers (subsidies) the public enterprises overall deficit increased to 3.5 percent and subsequently 5.5 percent. His conclusion was that public enterprises in LDCs are a major cause of stabilization problems (inflation and balance of payment difficulties).

Likewise, the World Bank (1988) in its 1988 World Development Report asserted that the net budgetary transfers to state-owned enterprises in eight developing countries ranged during 1983-1988 from more than one percent of GDP in the Dominican Republic to more than 5

percent in Sri Lanka⁵. However, the Report claimed that there were public enterprises which made sizable positive contributions to the budget. According to the Report the reason behind the negative budgetary impact of public enterprises is that "budgetary transfers have thereby been the unintended outcome of poor decisions in investment, pricing, and management" (World Bank, 1988, p.169).

Waterbury (1992) studied the relationship between public enterprises and the adjustment process in LDCs by focusing on the problems of public enterprises in four countries; Egypt, India, Mexico, and Turkey. Part of his work was devoted to the effect of the public enterprises in those countries on the budgetary deficit. He asserted that as a percentage of GDP the public enterprise budgetary deficit was 9.0 percent in Egypt (1986-1987), 3.2 percent in India (1988-1989), 2.0 percent in Mexico (1987), and 2.7 percent in Turkey (1990). The scholar noted that according to the figures above, "Turkey and Mexico run SOE deficits that are proportionately as large as the total public deficit of the United States" (Waterbury, 1992, p.197). However, in the case of Egypt the public enterprise deficit cannot be compared with that of other countries.

His conclusion, derived from his introductory argument, was that

⁵The countries were the Dominican Republic, Philippines, Sri Lanka, Benin, Egypt, Morocco, Tanzania, and Turkey.

"the SOE sector in developing countries is the major cause of the public deficit, which in turn fuels inflation, reduces international creditworthiness, crowds out private borrowers, and impedes export promotion" (ibid, p.183).

In his study of public enterprise reform programmes in developing countries Galal (1991) emphasized that there have been many attempts to reduce the budgetary burden of public enterprises in a number of countries⁶. In Thailand, for example, the reform of the public enterprise sector has remitted to the government more than it received during the period 1983-1988. Likewise, in Mauritius, government transfers to public enterprises declined from Rs 290 million in 1983 to Rs 160 million in 1985. However, in other countries such as Malawi and Senegal the net transfers from the treasury to public enterprises increased. Thus, the evidence of the budgetary impact resulting from the reform of public enterprises, as the researcher contended, is inconclusive. Failure, however, was the result of three factors: subsidy reductions were not accompanied by a programme of restructuring at the enterprise level; reform efforts concentrated only on one element of the equation, that is the transfers from the treasury, while neglecting the second element, namely, the outflow of funds from the public enterprises; finally, the important elements of the budgetary impact of public enterprises are implicit in the pattern of exemptions and preferential treatment of all kinds.

⁶The countries were Thailand, Turkey, Mauritius, Malawi, Congo, Senegal, Morocco, and Mexico.

In summary, the studies above have accused public enterprises in LDCs of having a negative impact on the public budget. However, there were success cases where reforming public enterprises proved to have a positive budgetary impact. Thus, privatization will not be the only solution to a country's fiscal crisis.

3.6: The Relationship Between Privatization and Development

In empirical work conducted by Yoder, Borkholder and Friesen (1991) for a sample of 45 Third World countries, the aim was to examine the following important questions; Is there an association between privatization (measured by private sector spending as a share of GNP) and development (measured by per capita income, life expectancy at birth, literacy rate, infant mortality rate, income distribution, and GNP growth rates). The distinction between this empirical study and all others is that it has examined the relationship between privatization and economic development in the wider scope rather than concentrating on the GNP growth rates as a meaning of development. It explained development as a mixture of growth and other human development indicators⁷.

After dividing the sample into three income groups, the researchers concluded that there was no support for the argument of an "over-extended" public sector in LDCs. The private sector on average contributed 74 percent of GNP

⁷The same argument is employed in this thesis.

and in no case did the public sector contribute more than 29 percent to the GNP. Moreover, there was no statistically significant correlation at the 0.05 confidence level between privatization (measured by the size of the private sector) and any of the development indicators. There was a negative, though not statistically significant, relationship between privatization and the development indicators for 21 of the countries included in the sample. At the 0.10 confidence level, *there was a statistically significant positive relationship a) between privatization and average GNP growth rates for the low-income countries, and b) between privatization and the share of income going to the lowest income groups (in the middle-income and upper middle-income countries).*

Based on the empirical findings of this study, the research group concluded that "the claims of privatization have been overstated and unsubstantiated" (Yoder, et al., 1991, p.432). Nevertheless, the research group did not fall into the same error as privatization in finding a negative relationship between public sector size and economic growth. The cure must be in the private sector. The scholars instead argued that the size of the public or the private sector will not make a significant difference. However, the difference may be found in the investigation of the regulatory environment, trade policies, and fiscal and monetary policy; in other words, the institutional factors which determine interactions in the complex process of development.

3.7: The Reasons Behind Privatization

In a recent study, Ramamurti (1992) tested five hypotheses regarding the reasons for privatization using a sample of 83 developing countries. Within this sample there were 34 non-privatizers, 21 cautious privatizers, and 28 actively privatizing countries. The hypotheses examined were that privatization occurs in countries characterized by, a) higher fiscal pressure on governments (high budgetary deficit, large domestic public debt, and large external debt), b) higher dependency on loans from international organizations (World Bank and IMF), c) a large share of SOEs in total investment, d) inferior SOE performance in comparison with non-privatizers, and e) lower long-term growth.

The empirical test of these hypotheses revealed that privatization occurs in countries with higher financial problems, such as a large budgetary deficit and external debt, as a percentage of GDP. Also, there is a positive correlation between privatization and dependency on loans from international organizations. That is to say, the greater a country's dependence on loans from the World Bank and IMF, the greater the probability of being an active privatizer. However, the econometric analysis does not support the assumption that privatization is related to poor financial performance by SOEs and poorer long-term growth. The researcher pointed out that in Latin American and Asian countries, the increasing trend towards privatization is related to their past "overuse" of SOEs

(larger weight in the economy) and their faster growing private sector.

In Africa, on the other hand, privatization has been imposed by external factors, particularly the pressure exercised by the World Bank and IMF, although the conditions for privatization were not necessarily appropriate. In fact, the study found that in African countries "privatizers did not have significantly larger SOE sectors than nonprivatizers, nor did they experience growth rates that were significantly higher than that of nonprivatizers" (Ramamurti, 1992, p.241). On the other hand, the researcher observed that the set of opportunities provided through privatization to the multinational corporations (MNCs) has provided the latter with new avenues to gain entry into sectors that were previously barred.

The findings of this empirical study asserted that a government's desire to sell enterprises and raise revenue from asset sales to balance the government budget would mean that no objectives, and in particular that of economic efficiency, are effectively attained. Governments must be clear about their objectives. Are they more interested in receiving maximum income from privatization, attracting foreign capital and investment into the economy, improving the management and efficiency of the enterprises to be privatized or rolling back the state's role in the economy.

3.8: The Relationship Between Privatization and the Distribution of Gains and Losses

In this last group of empirical works there are three studies which investigated the effects of privatization on the distribution of gains and losses between domestic consumers, shareholders, employees and foreigners.

Jones and Abbas (1992) conducted a study of three privatization cases in Malaysia; Malaysian Airlines, Kelang Container Terminal and Sports Toto. In the first case the domestic consumers lost around 600 million Ringgit and the major beneficiaries were foreign consumers (3196 million Ringgit) (ibid, table no.12-31). In the second case, the domestic consumers benefited by only 58 million Ringgit, and foreigners by 29 million Ringgit while the major beneficiaries were the domestic concentrated shareholders (109 million Ringgit) (ibid, table no. 13-17). In the case of the gambling company (Sports Toto), the society gained 121 million Ringgit, the government 147 million Ringgit and private buyers 112 million Ringgit while the main losers were the formal and informal gambling sectors (-69 million Ringgit). Thus, looking at the consumer gains from the three selected cases it appears that the consumers lost in one and gained in the other two.

In the case of Chile, Galal (1992) selected three privatized companies as a basis for his empirical study of the consequences of privatization. In the first case, the

privatization of the electricity generating company (CHILGNER), there was no effect on consumers because the company was a price taker. However, the private domestic shareholders benefited by Ch\$3.8 billion and foreign shareholders by Ch\$2.7 billion (ibid, table no.8-27). The second case, that of the electricity distribution company (ENERSIS), showed that shareholders were the biggest winners (Ch\$42.9 billion) while consumers were better off by Ch\$7.7 billion (ibid, table no.9-27). According to Galal, the sale of the telecommunication company (COMPANIA DE TELEFONOS DE CHILE) resulted in gains to the consumers of Ch\$516 billion while private shareholders benefited by Ch\$8 billion and foreign shareholders by Ch\$39 billion (ibid, table no.10-26).

In total, the divestiture cases of two out of the three above companies were distributional-enhancing in relation to the impact on consumers while one was neutral in its effect.

The third study by Tandon (1992) concerned three Mexican privatized companies. The privatization of the telecommunication company (TELEMEX) pointed to large losses in consumer gains because of large price increases during 1988-1991 (ibid, pp. 18-19). This may have been related to the fact that more than 50 percent of the company is owned by foreign shareholders who were the main winners (ibid, table no.16-15). In the second case, the privatization of AEROMEXICO led to a net loss on the side

of consumers while the government and the buyers of the company gained the most (ibid, p.35). The third case demonstrating the effect of privatization on distribution is that of Mexicana Airline. The analysis of distributional impact reveals net losses on the side of domestic and foreign consumers while the major winners were the government and domestic shareholders (ibid, table no.18-17).

Thus, in total, privatization led to net losses on the side of consumers in all three cases although the first two might indicate total gains after taking into account other parties such as the shareholders and the government.

In summary, the above nine cases revealed that shareholders are the main winners while the consumers, in most of the cases, were the main losers. This result contrasts with the conclusion of the three above researchers because they argued that the welfare effect should be taken rather than the distributional impact on the part of consumers alone. Thus, their studies which formed part of the 1992 World Bank Conference on the "Welfare Consequences of Selling Public Enterprises", concluded, as the conference did, that privatization can enhance welfare rather than reduce it. However, as we have indicated, such an analysis should focus mainly on the distributional impact, particularly consumers who represent the wider and the most important spectrum of the affected group.

3.9: Conclusion

This review of empirical evidence suggests that there is no conclusive evidence on the microeconomic level to support the argument of private ownership superiority. According to the investigation of the efficiency records for the two type of ownership it has not been found that private ownership is superior to public ownership in all cases, but rather that there are even differences between the public enterprises themselves in different countries. Likewise, on the macrolevel, there is no clear cut evidence that public investment is crowding-out private investment, but in many studies it has been found that there is a complementarity effect between public and private investment.

In the context of the relationship between government size and economic growth, the empirical studies reviewed concluded that such a relation is vague and dependent on the methodology employed by the different scholars although there are no empirical grounds either for a rejection of government intervention or for an increase in its size. The studies appeared to indicate that what is important is the quality and the type of government intervention.

The review of the empirical studies investigated the budgetary impact of public enterprises in developing countries and suggested that the burden such enterprises

place on the public budget could be reduced by a comprehensive programme for reforming the public sector. Without such an approach privatization might prove to be a more attractive cure for this problem, from the government point of view, as has been the case in many developing countries.

On the correlation between privatization and development, one empirical work concluded that there was no statistically significant correlation at the 0.05 confidence level between privatization and all other development indicators. The conclusion of the work directed attention to the study of the impact of the institutional factors that may play a pivotal role in the process of development. Development, however, is not equal to economic growth but should include the factors of human development.

In the investigation of the reasons behind privatization it was found that higher fiscal difficulties and dependency on loans from international agencies such as the World Bank and the IMF are the main factors driving privatization in developing countries. This means that the conflicts in government objectives regarding privatization has made economic efficiency subordinate to the goal of easing the budgetary deficit.

In the last dimension, the review of nine cases of

privatization in three developing countries revealed that in the majority of the cases the consumers are the losers while the government, domestic buyers and foreign owners are the major beneficiaries from privatization. This result may challenge the belief in the positive effect of privatization on welfare. The latter is true if we account the increase in the welfare of other segments of the population apart from the consumers.

In summary, the empirical evidence shows that the effect of privatization through change of ownership may not play a significant role in enhancing the economic performance on the micro and the macro levels. Thus there is need for a more cautious approach in advising the application of such a policy in developing countries.

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Chapter 4

Privatization, Decentralization, Participation, and Development

- 4.1: Introduction**
- 4.2: The Meaning of Development: Growth vs. Human Development**
- 4.3: Privatization, Choice, and Participation**
- 4.4: Privatization in the Context of Exit and Voice**
- 4.5: The Concept of Decentralization**
- 4.6: Privatization vs. Territorial Decentralization**
- 4.7: Paradigms of Decentralized Development**
- 4.8: Decentralization in Practice**
- 4.9: The Effect of Privatization on Technological Choice and the Informal Sector**
- 4.10: The Necessity of Coordinating the Efforts for Development**
- 4.11: Conclusion**

4.1: Introduction

Privatization is often described as the transfer of state assets and /or control (partial or full) to the private sector. The implication for development is derived from the belief that private ownership/or control brings greater economic efficiency, more innovation, improved responsiveness to consumer demands, and wider choice for individuals (i.e., shares, goods). The argument of maximizing profits also implies increased savings and greater investment which in their turn produce rapid growth and higher incomes, both symbols of development. This approach can be called an income-centred approach to development.

From the decentralization perspective, which is the domain of this chapter, privatization means decentralizing decision-making away from the monopolistic centralized bureaucracies and back to the market.

In this chapter we will consider an alternative approach which implies the use of concepts such as "choice", "participation", "voice", "appropriate technology", "linkages", and "territorial decentralization or devolution". Such an approach embraces a wider concept of development and in particular looks at human development centred on enhancing capabilities as the ultimate objective of development rather than the growth in GNP.

The World Bank has identified its economic policy priorities for the 1990s. Poverty alleviation and an

increase in equity are among the first considerations. Is privatization, as one component of the free-market oriented strategy strongly advocated by the Bank, able to make a positive contribution to the achievement of these goals? What is the relationship between privatization and the poor within consumer choice perspectives?

It is often argued that privatization is the ultimate phase of decentralization with the latter a means to achieve the former (World Bank, 1988, p.10) (Rondinelli and Nellis, 1986). Is decentralization in the context of "giving power to the people" symmetrical with the privatization lessons experienced by LDCs?

The globalization of economic policy choices seems to be a feature of the current economic environment, particularly after the collapse of the former Soviet Union and the end of the Cold War between 1989 and 1991. Can such a globalization of the development process be of advantage to the LDCs in adapting appropriate technology, internal innovation, and balanced regional development? Would the use of Western instruments such as privatization promote development or, conversely, would a bottom-up approach offer a genuine alternative?

In raising such questions the chapter does not pretend to have definitive answers but rather to open the way to deeper discussion of this subject which, although often considered important, is generally given scant attention.

4.2: The Meaning of Development: Growth vs. Human Development

One of the major problems economists have faced since the 1940s has been achieving consensus on the meaning of development. The evolution of development economics as a field of economics itself required a change in the meaning of development in different periods.

During the 1950s and early 1960s, economic development was associated with economic growth in per capita income (i.e., 5 percent annually) but in the 1970s it was redefined from the liberal context of "growth with equity". As Little (1982, p.6) noted: "it is economic growth that allowed more equitable consumption as well as growth in consumption per se". Its new wider definition implied the reduction or elimination of poverty (basic needs), inequality, and unemployment within the context of a growing economy. The emphasis during the 1980s and 1990s has been on growth and efficiency as a way of reducing poverty, unemployment, and inequality.

Chambers (1991) pointed out that the "growth with redistribution" ideology which dominated the 1970s could be seen as different from, if not actually in polarity with, the "neoclassical counter-revolution" ideology which dominated the 1980s and 1990s. However,

"Both ideologies, and both sets of prescriptions, embody a planner's core, centre-outwards, top-down view of development. They start with economies, not people; with the macro not the micro; with the view from the office, not the view from the field. And in consequence their prescriptions tend to be uniform, standard, and for universal application"

(Chambers, 1991, p.246).

More recently Ingham (1993) identified nine dimensions through which the meaning of development can be examined. Although the dimensions are correlated with each other, they were divided into development in the context of: historical growth; structural change; modernization; political change; decentralization and participation; redistribution and basic needs; human development; sustainability; ethics and morals.

The scholar concluded from empirical studies that human development and poverty reduction are the most valuable objectives of development which can be achieved by increasing political and civil liberties¹:

"Countries whose citizens enjoyed greater political and civil liberties also preformed better in people-centered measures of development, in life expectancy at birth, in real income per head and in infant survival rates" (Ingham, 1993, p.1819).

This conclusion related more closely to the "capability approach" to development developed by Sen (1983, 1988, 1989, 1990) and adopted by the UNDP (1990, 1991, 1992, 1993) in its Human Development Reports, than to that embodied by the World Bank in its 1990 Development Report on poverty.

This divergence between the World Bank (1990) and UNDP (1990, 1991, 1992, 1993) views on the meaning and objectives of development is pivotal to the analysis of

¹One of the important empirical studies which established a strong relationship between development, democracy, and growth is that of Pourgerami (1988).

privatization within a framework of decentralization. The difference of view is important for two reasons; the first is the influential role the World Bank has played, particularly from the late 1980s, in advocating and forcing the drive towards privatization in LDCs, which complemented the Bank's vision of development; the second is the Bank's income-centred and growth dependent view of development. This separates it from the capability approach to human development which measures development by the Human Development Index (HDI) taking into account factors such as the quality of life, life expectancy, literacy and adjusted income.

According to Mosley only 13 percent of structural adjustment loans (SALs) provided by the Bank to 21 LDCs, up to the beginning of 1986, were specifically attached to conditions of privatization of public industries or agricultural marketing facilities while 62 percent required various forms of deregulation (Mosley, 1988, p.134).

By the first half of 1992, however, the Bank's figures reveal that 70 percent of all SALs and 40 percent of all sectoral adjustment loans (SECALs) were in support of privatization. In total 182 Bank operations, between 1981 and the first half of 1992, implied privatization in 63 countries, half of them in Sub-Saharan Africa (Kikeri, et al., 1992, p.32). Thus, there is a significant influence from the Bank in the restructuring of economic policies in developing countries.

What differentiates the capability approach to human development from the income-centred approach favoured by the World Bank?

The main differences lie in the means and ends of each approach.

In the capability approach Sen (1989) criticized the use of opulence measurements such as income, wealth or commodity possession and other utility measurements such as happiness, desire fulfilment, or even the simple utility of choice. His criticism derived from the inability of such measurements to deal with achievements, self esteem, freedom, and capabilities, all of which involve non-income or non-utility information.

"The evaluation of commodity-holdings or of incomes (with which to purchase commodities) can be at best proxy for the things that really matter, but unfortunately it does not seem to be a particularly good proxy in most cases" (Sen, 1990, p.47).

So capability derives from the freedom to be well, which in simple terms is about the ability to live longer, be literate, be healthy and well-nourished and generally enjoy a higher quality of life. To be capable would be an end in itself.

In contrast, the World Bank approach, which is based on mainstream income-centred evaluation, looks exclusively at the investment in human capital (education, health, and nutrition) as a way of increasing productivity so as to increase income and growth which in turn will reduce poverty. In this case the calculation is based on the viability of the rate of return on such an investment. The

following quotations from the World Bank (1990) describe the means and ends.

"The principal asset of the poor is labor time. Education increases the productivity of this asset. The result at the individual level, as many studies show, is higher income. Most recent research also points to a strong link between education and economic growth" (World Bank, 1990, p.80).

"The effect of better health and nutrition on productivity is less well documented than the effect of education. An increasing number of studies, however, show a positive effect on agricultural productivity (World Bank, 1990, p.81).

Such different approaches to the means and ends of development will subsequently effect the policies employed by the two organizations, the World Bank and the UNDP, in describing the ends of development. While economic growth for the World Bank is seen as an instrument for reducing poverty, the capability approach regards the public provision of social services as the principal medium for human development. Moreover, even markets in the latter are the means and human development is the end (UNDP, 1992).

Thus, it is not surprising that the World Bank regards privatization as an instrument for reducing poverty as stated in the opening sentence of a recent Bank study of privatization: "The World Bank Group supports privatization in the context of its broader goals of economic development and the reduction of poverty" (Kikeri, et al., 1992, p.1). In this context economic development is a synonym for growth using the trickle-down argument.

By contrast UNDP (1993, p.48) is concerned about the effects of privatization on reducing social services to the people.

"In the face of rising unemployment and poverty, social security systems are finding it increasingly difficult to cope. State-owned enterprises used to distribute most social benefits, from child care to health care to pensions. But over the past three years, these widespread automatic benefits have been dramatically curtailed and are being replaced by "social safety nets" whose services are targeted more narrowly - and thus risk missing millions of people in desperate needs" (UNDP, 1993, p.48).

In fact the "social safety nets" are those proposed by the World Bank's 1990 Development Report in support of the poor.

In summary the meaning of development should be understood within the context of increasing human development. This requires an increase in freedom through a participatory approach in which the people's well being is the end and empowering them through decentralization represents the means.

4.3: Privatization, Choice, and Participation

The essence of "public ownership" is that it provides people, as owners or as consumers, with a theoretical right to intervene in the production process. In practice, however, they do not.

According to the "public choice" theory, the achievement of public interests is delegated to politicians, bureaucrats and technocrats who take decisions in the

public arena². The theory argues that there are no grounds for believing that such delegates will behave in the interests of the public; rather they will maximize their interests or utility functions with a resulting deterioration in allocative efficiency. Moreover, according to the "public choice calculus" public ownership brings about a reduction in social welfare. Hanke and Walters (1990) assumed that there would be a 50 percent reduction in total costs if public enterprises were privatized. This would lead to a subsequent increase in social welfare.

The advocates of privatization often argue that "choice" is the main value of privatization because the market place enhances the ability of individuals to choose their own share of the goods and services they demand. In other words public choice theory believes in "consumer sovereignty". The market place is seen to aggregate individual choices thus bringing about an accountable and effective means of allocating and producing goods.

The important question is whether more choice for shareholders and consumers provides every one with an equal opportunity to participate in the markets of developing countries or not.

It is well known that privatization as a phenomenon is almost the novelty of the Western countries and that one of its components is the concept of "people capitalism" as

²For a review of the theory read chapter 1.

a way of broadening the ownership base, as was the case in Britain (Marsh, 1991, p.474).

In developing countries the same slogan has been adopted but with far less impact than has been the case in Britain, for instance. In most developing countries as well as in some Western countries there are two main restrictions on the effectiveness of "people capitalism". The first is the relatively small size of the middle income group who can acquire shares, and the second is the thin spread or non-existence of capital markets (Suleiman and Waterbury, 1990, p.15).

For example a survey carried out by the World Bank on privatization transactions in 90 countries showed that there were 530 recorded transfers to single buyers in the countries of Sub-Saharan, Brazil, Italy and Spain (Nankani, 1990, p.44). More recent data which records individual privatization transactions, over \$100 million in value between 1988-1991, reveals that out of 28 divestiture cases in 11 developing countries only 5 were transferred through public offerings while the remainder were divested through private sales (Kikeri, et al., table no.1, p.26).

Although the total value of the transactions was \$41.979 billion, only \$3.5 billion was transacted through public offerings which, in proportionate terms, means only 8.3 percent (calculated by the researcher from *ibid*).

This indicates that ordinary people, and the poor in particular, were excluded from the opportunity of share

ownership and consequently from participation. Furthermore, even if there were such a wide share-owning base, it is likely that small shareholders would quickly sell their shares on to larger shareholders in order to generate short-term profits via the market. If privatization by broadening share ownership is unlikely to make an impact on equity ownership in Britain, as Marsh (1991, p.475) noted, how can one expect it to have a better impact on LDCs?

Carlsen, writing about Mexico, noted that:

"Few nationals have the money or international contacts to buy government-owned companies. This constrains the number of eligible bidders, weakens bids and means that the few who are able to purchase previously state-owned enterprises can extend their economic reach, an unwelcome prospect given the extreme concentration of wealth and power in Mexican society" [Carlsen (1992, p.19) as cited in Martin (1993, p.100)].

In Sri Lanka about 70 percent of all shares is concentrated in the hands of about 2000 people while in Pakistan some 6000 persons hold about 80 percent of all shares. Likewise in India a sample of companies covered by a study conducted by the Reserve Bank of India in 1978 revealed that less than 0.4 percent of the total number of shareholders (in companies with capital above 50,000 Rs) held about 70 percent of the total paid capital (Ramandham, 1989, p.41). Another recent example is the privatization of the Indonesian state-owned Tyer Maker (Intirub) in 1990 where the government sold 70 percent of the enterprise to a local conglomerate, Bimantara Citra, controlled by Suharto's son (Montagu-Pollock, 1990, p.35).

These examples demonstrate that unless privatization of SOEs is well designed it neither increases choice nor alleviates poverty. On the contrary, it concentrates power in the hands of the market place elite. This runs contrary to the objectives of development as a participatory approach to human well-being.

The term "well designed" privatization may include schemes which target specific groups such as employee participation (e.g., employee ownership, profit sharing, and participation in decision making) within the original privatization plan. Employee participation fulfils many objectives such as; increasing productivity; avoiding enterprise bankruptcy; broadening the distribution of ownership; and facilitating privatization proceeds (Lee, 1991, p.1).

The theoretical argument for employee participation in decision making derives from the specific knowledge of production which the employee possesses. This increases productivity and also reduces the agency costs, particularly when the employees possess a stake in the enterprise. It also enables the employees to enhance their capability of controlling their work lives. Organizing workers into natural work teams and empowering employees at all levels, as in the case of Quality circles (QC), simply reduces the need for supervision and reduces the

burden on managers³. However, the attitude of managers toward participation may be negative as an empirical study of 8 medium-sized industrial plants in Bangladesh shows (Ali, et al., 1992).

The experience of privatization with employee participation in developing countries is in its infancy. A programme of privatizing seven large SOEs in South Korea in 1991 focused on increasing efficiency and the equality of income distribution in the economy as a whole. The People's Share Programme, as it was called by the Korean government, allowed low-income individuals and 20 percent of employees to purchase 75 percent of shares (Lee, 1991, p.15). In this way the government achieved many goals. It enhanced the distribution of income, reduced the opposition to privatization, and increased efficiency. Such an approach reflects what we call a "carefully designed privatization". However, according to Lee, only four developing countries have experienced such schemes (Argentina, Poland, Sri Lanka, and Jamaica), and until now the assessment of the experience has revealed mixed results (ibid).

The second argument of choice is based on the belief that consumers possess rational choices and will exercise their power by choosing among competing suppliers in the market.

³A quality circle is a group of employees that meets regularly to solve problems affecting their work area. The members receive training in problem solving, statistical quality control, and group processes (Lawler and Mohrman, 1985).

Here the argument of relative prices, in which the prices will determine the demand and consequently the supply, might not apply in all cases, particularly as many privatized enterprises in developing countries sustain their monopolistic position in the market. For instance, in 1989 a tomato processing factory was privatized in Iraq. Before privatization one pound of concentrated tomato puree was priced at half an Iraqi dinar while directly after privatization the price jumped fivefold to 2.5 Iraqi dinars. As there was no alternative, demand was relatively unaffected and the enterprise continued to exercise its monopoly power over the consumers (Abu Shair, 1989, p.50).

In societies with different cultures and values as well as extremely uneven income distribution, the assumption of rational choice from the Western point of view might not apply because of religious principles, political constraints, social taboos and well-ingrained economic practices (Slater, 1989, p.522). In other words the rational choice assumption might be incompatible with the "power of belief". However, even if it were compatible, it would be the richer classes of the developing countries who would enjoy the benefits, unless privatization is well designed to enhance equal opportunity and equal access.

Another important aspect of choice according to the public choice theory and most proponents of privatization is the

belief in only "individual choice". It might be important to recognize that choice in itself remains desirable as a value for the individual although in traditional societies, as is the case in many developing countries, "collective choice" (i.e., malnutrition) and "instrumental choice" are what the society is looking for in order to improve well-being and capability rather than choice as an end in itself as is the case in privatization (Higgins, 1988, p.203) (Marglin, 1990, p.4).

In short, as privatization leads to growth, choices would only expand in some dimensions, as the economic history of developing countries reveals. Thus, privatization would reduce the concepts of "freedom of choice" and "collective choice" to the narrower notion of "individual choice" if it were pursued as a reaction to a financial crisis. Consequently, while some people will be better off, the vast majority of the poor will be worse off. As Riddell put it, "privatization would leave development to the vagaries of exploitative forms of primitive exchange" (Riddell, 1985, p.215). However, another explanation of choices could be derived from Hirschman's concepts of exit and voice.

4.4: Privatization in the Context of Exit and Voice

Hirschman (1970) in his theory of exit, voice, and loyalty emphasised that economists tend to use the option of market forces as the only option available to achieve

equilibrium in the market. It had long been thought that the more elastic the demand, the better the economy was functioning. This option, according to Hirschman, means the exit option. In this option customers of a firm or members of an organization choose to stop buying the firm's product or quit from the organization as a demonstration of their dissatisfaction with the firm's product or the organization's policies. As a result, revenue drops and a decline in membership would force management to correct their inadequate performance. Hirschman's argument against the use of the exit option on its own came about from his questioning the role of competition and its ability to lead firms/organizations to "normal" efficiency, performance, and growth standards after they have lapsed from them (ibid, p.22).

As a result he argued that "non-market forces" (voice) are not necessarily less "automatic" (exit) than market forces, particularly in the world of quasi-perfect competition (ibid, p.25).

In this case voice would mean a mechanism for change from within rather than escape (exit).

"Voice is here defined as any attempt at all to change, rather than to escape from, an objectionable state of affairs, whether through individual or collective petition to the management directly in charge, through appeal to a higher authority with the intention of forcing change in management, or through various types of actions and protests, including those that are meant to mobilize public opinion" (ibid, p.30).

Hence, Hirschman is advocating a participatory approach similar to that emphasized by the UNDP.

The superiority of voice over exit according to Hirschman is due to the voice option's capability of evolving in different and new directions. No such capability is available for the other option (exit). The UNDP noted that participation, which is in this case a synonym for voice, gives people access to a "much broader range of opportunities" (UNDP, 1993, p.21).

Hence, the explanation for introducing privatization policies on their own would be as a way of employing the exit option rather than exit and voice together. So, while voice denotes an opportunity for "change from within", exit seems to offer its supporters little challenge.

The question is: which factors affect the activation of voice?

The voice option seems to be dependent on three main factors. The first is loyalty. This implies that loyalty is important through its capability of neutralizing, within certain limits, the tendency of the most thoughtful customers or members to be the first to exit (Hirschman, 1970, p.79). However, loyalty, in order to be functional, needs to have some social incentive to initiate a collective action for change.

On the other hand, Hirschman argues that loyalty is at its most functional level when it looks most irrational, or when loyalty "means strong attachment to an organization that does not seem to have warrant such attachment because it is so much like another one that it is available" (ibid, p.81).

This could explain why voice is a functional mechanism in Olson's distributional interest groups (Olson, 1982)⁴. In this case, as long as the number of members in the group is small, there seems to be a highly effective role for loyalty to bring about effective pressure. Nevertheless, loyalty in Olson's distributional groups does not provide the socially useful services which Hirschman advocates. Rather, they use their loyalty to the group as a way of gaining benefits at high cost to the society concerned. Thus, their collective action implies higher costs to society.

Another factor determining the activation of voice is the elasticity of demand. As long as this is low, the possibility of voice being more active is high. Thus, Hirschman argued that voice was used more often in the former socialist countries as well as in developing countries where the ability to exit is low. However, such voice seems to direct efforts towards the other extreme option, which is exit, but without any success in the recuperation of the status of their economies. However, there is a level where the low elasticity of demand compounded with income constraint could bring about mass collective action. Riots in developing countries as a mechanism of dissatisfaction with government mismanagement of the economy and the high costs of economic reforms are clear evidence of this. In such cases, the elasticity and

⁴More discussion on the collective action theory of Olson in chapter 1.

income factors offer an incentive for collective action which benefits more than it costs.

The third factor which affects the employment of the voice option is its cost or the cost of the collective action for recuperation. In order for reformists in developing countries to benefit from the advantages of change from within they have to innovate and initiate mechanisms that reduce the cost of employing voice for constructive purposes as well as rewards for the people who initiate it. Productive incentives are the determinant factors in inducing institutional change, as North (1991) noted.

Nevertheless, there is one criterion which has to be distinguished in introducing the voice option. Hirschman called this the case of the "lazy monopolist". Some monopolies, particularly in the state sector, might welcome competition or the exit option as a way of bringing about relief from public criticism and pressure, especially when they operate under protection of the state. In such cases, the management of such a monopoly would not enhance its performance after the use of the exit option by its customers. Hirschman gave as an example the Nigerian Railway Corporation. The quality of its services were deteriorating and the customers for short distances deserted the railway in favour of road transportation systems without putting any pressure on the management of the railway to reform their services. Thus, the exit option can deny society an opportunity to

increase the pressure for change.

Hirschman's theory of exit and voice provided the reformists with a new direction of thinking replacing the traditional method of using the financial discipline or the market (exit) option to introduce the recuperation initiative. The use of the two combined in different proportions would depend on the environment and the history of each case under investigation. The main conclusion is that "non-market forces" are no less automatic and efficient than "market forces" in bringing about recuperation if there is a commitment on the side of decision makers to enhance the possibilities for change from within. This is because privatization means the decision to escape rather than to challenge. For that reason the UNDP approach and Ingham's conclusion (1993) regarding the meaning of development lie in the use of exit and voice together, particularly when the latter can be enhanced through decentralization and democratization.

UNDP (1993, p.50)) listed seven sins of privatization

1. Maximization of revenue rather than creating competition.
2. Replacing public monopolies with private monopolies.
3. Corruption and nepotism through non-transparent procedures.
4. Using sale proceeds only to finance budget deficits.
5. Crowding the financial market with public borrowing at a time of public disinvestment.

6. Making false promises to the workforce.

7. Relying on executive orders rather than political consensus

Ikenberry (1990) argued that privatization is a government reform movement rather than a social one and that government can build a coalition to protect its privileges. It is a reaction to fiscal crisis, economic inefficiency and/or international pressure. In such cases people (and their organizations) would resist privatization, using the voice option (i.e., protests and riots), not because they are in favour of bureaucratization, but because they demand a reform that would give them more participation in the progress and development of their communities. The interest groups, as the neoclassical political economists termed them, in developing countries, especially non-governmental organizations (NGOs) (e.g., trade unions, women movements, farmers cooperatives, religious organizations, and the like), are the same people who elsewhere are called "anti-systematic" movements (referring to movements against centralization and bureaucratization) as in the case of Latin America, India, and Africa (Slater, 1989, p.522) [Wallerstein (1974) cited in Banuri (1990, p.53)]. The same people, with different nominations, demand one important right, namely "popular participation" through decentralization of power to them and not to the market or representatives at the centre.

4.5: The Concept of Decentralization

Decentralization is a concept with different definitions, meanings and benefits. No overwhelming consensus has been reached regarding it. However, it is believed that decentralized development could be seen as a genuine future alternative for development in developing countries.

Such a belief started as a reaction to the economic difficulties developing countries have faced during the last three decades, in particular the "unbalanced development" as witnessed by uneven rural development, poverty and inequality in the distribution of income (Griffin, 1981, p.225). Moreover, as Banuri argued (1990, p.98) it has been seen as a vision of the future in most developing countries.

The question is whether privatization or another meaning of decentralization is seen as a vision of the future?

Conyers (1984, p.187) argued that there are two main definitions of decentralization. The first is functional decentralization, which means the decentralization of production or/and services to parastatal or non-government organizations. Thus, privatization policies are included in a definition which deals with functions only. The second definition is territorial decentralization. This means the decentralization of government to sub-national levels such as local governments or authorities.

The advocates of privatization and market oriented paradigms in general are consistent in their belief in the

first definition of decentralization. Moreover, they use the two concepts of decentralization and privatization as synonyms although privatization is sometimes seen as the ultimate phase of decentralization⁵.

"The problems of providing and maintaining public services and infrastructure have brought increasing calls for decentralization and privatization, and many governments are now decentralizing responsibilities for service and infrastructure provision, financing and management"(Rondinelli, et al., 1989, p.58 from Rondinelli, et al.,1983 and Rondinelli, 1987).

Rondinelli and his associates (1989) also believed in decentralization defined from the public choice theorists' perspective; that is, "a situation in which public goods and services are provided primarily through the revealed preferences of individuals by market mechanism" (Rondinelli, et al., 1989, p.59).

However, in theory at least, they emphasized that concepts such as people participation, empowerment and local democracy were included in their vision of decentralization. For example the US Agency for International Development (USAID), under the Foreign Assistance Act of 1966, adopted in its missions the concept of grass roots participation.

⁵Rondinelli and Nellis (1986, p.5) argued that decentralization has a wide scope ranging from simply adjusting workloads within central government organizations to diverting all government responsibilities for performing a set of what were previously considered public-sector functions. In that they categorized decentralization into four types within developing countries experience; deconcentration; delegation; devolution; and privatization. Such a classification reveals that the emphases are almost all on functional decentralization.

"maximum participation in the task of economic development on the part of people in developing countries through the encouragement of democratic, private and local government institutions" (quoted from Ingham and Kalam, 1992, p.374).

The World Bank concept of decentralization is restricted to "fiscal decentralization " which means;

"decentralizing both spending and revenue authority can improve the allocation of resources in the public sector by linking the cost and benefits of local public services more closely" (World Bank, 1988, p.154).

However, in practice the World Bank does not advocate empowering the poor to restore the unbalanced nature of the decision-making processes and the powerful position of the government elite. Its suggestion is that poverty should be alleviated not through the devolution of power or territorial decentralization but by designing poverty-reduction policies that would not be resisted by the non-poor (which is not the right word) or, in real terms, the rich and powerful elite who guard the gates of the decision -makers.

" The nonpoor [sic] are usually politically powerful, and they exert a strong influence on policy. Giving the poor a greater say in local and national decision making would help to restore the balance. But since political power tends to reflect economic power, it is important to design poverty-reducing policies that would be supported, or at least not actively resisted by the nonpoor" (World Bank, 1990, p.52).

The interesting point is that the same report identified privatization among the factors that have contributed to poverty in rural areas (ibid, p.32).

As Cardoso and Iielwege (1992, p.19) stated, "economic poverty reflects political poverty: the poor lack the

means for voicing their demands". In this case poverty-reduction programmes will not empower the poor but rather sustain the existing power structure.

It seems that there is a consistency in the argument adopted by the international agencies and the advocates of market-oriented policies, namely that privatization should be the ultimate goal of decentralization. It is for this reason that the emphasis has to be placed on territorial rather than functional decentralization. The question to be asked is why?

4.6: Privatization vs. Territorial Decentralization

The proponents of privatization are concerned with transferring state-owned enterprises to the private sector as well as introducing competition in the market. But there are two factors which have been neglected in the analysis of privatization. The first is space and the second is the structure of government.

4.6.1: The Space Factor

One of the major differences between market-oriented strategies and those of territorial decentralization is that the first (without solid evidence) considers shifting the production functions from SOEs to the private sector for purely economic reasons⁶.

In the case of territorial decentralization, development

⁶Evidence in chapter 3.

requires not only the production of goods and services but also the production of complex political, social and economic goods. Such a concept requires complex and coordinated efforts by diverse people across a large area of space. In this case, the space concept would include not only the geographical meaning of the word but also rules, behaviour and the institutional factors (i.e. history, politics) within this space (Miller, 1992). Thus, it is a territory where people can communicate as well as struggle to achieve their objectives of prosperity within the context of their satisfaction with the process itself.

It is introducing the place factor which, as Barnes and Sheppard (1992) argued, can explain the rationality of human actions because the latter "varies systematically and unpredictably according to the context in which the action occurs" (Barnes and Sheppard, 1992, p.18). In this case this dimension would imply complexity, people's capacity, control of technology, innovation, participation, inside and outside linkages, flexibility and development from below and within⁷. Territorial decentralization refers to the territorial distribution of power. Smith's definition is that;

⁷A more detailed analysis of these concepts will be introduced in the following sections.

"It is concerned with the extent to which power and authority are dispersed through the geographical hierarchy of the state, and the institutions and processes through which such dispersal occurs. Decentralization entails the subdivision of the state's territory into smaller areas and the creation of political and administrative institutions in those areas" (Smith, 1985, p.1).

Thus, devolution enhances political participation or democracy as well as economic participation by increasing local entrepreneurial activities. This is not what happens to the notions of deconcentration and delegation where the central authority retains effective control and power over the local level, thereby neglecting the needs of local people.

Likewise, in the case of privatization, there is no space factor within the context of the local community, but a market where rational individuals, consumers and producers compete to maximize their utility functions, whatever they are.

Also, in privatization, there are standard and quantitative ends which draw the line between efficient and inefficient. A universal approach to growth and relative unity in implementation is required. Thus, it could be described as an approach to development from above.

4.6.2: The Structure of Government

Another factor which is not included in the privatization prescription is the structure of government. It is known that privatization is not a social movement but a decision

taken and enforced by government because of financial pressures. Logically that would imply a powerful and authoritarian government in order to withstand the voices of discontent. Privatization does not discuss the legislation and judiciary rules of the state intended to implement it. It does not discuss the creation of grassroots organizations (GROs) outside the bureaucratic structure or the institution building requirement. Nor does it look into possible reforms within the existing structure itself. Both these are, however, important if activation of the voice option is to be enhanced and the hierarchical structure of the centralized state broken down.

Such missing factors can explain why people resist privatization in developing countries. In other words the opposition to privatization is derived from its inability to deliver participation and freedom, factors which increase the capability of individuals at the local level. Privatization transactions have been limited in developing countries. Between 1980 and 1991 6832 SOEs were privatized worldwide, 66 percent of them in one country (the former GDR), 12 percent in Eastern European countries (other than the former GDR), 2 percent in OECD, and the remaining 20 percent in developing countries (Kikeri, et.al., 1992, pp.22-23).

Commenting on the experience of mass privatization in the former GDR, professor Dieter Bos said that:

"Buyers are chosen carefully, with the wider interests of the region in mind. The state fiduciary body charged with carrying out privatization (Treuhand) has sold enterprises for as little as one German mark to avoid their falling into the hands of West German entrepreneurs who might want to simply buy up potential rivals and close down their production lines" (emphasis added) (McIntosh, 1993, p.24).

However, that is not the case in developing countries, as our previous evidence reveals. Furthermore some commentators believe that the privatization process in developing countries might be reversible as has already taken place in Chile (1983) and in Japan in the second half of this century (Suleiman and Waterbury, 1990, p.19) [Wilson (1988, p.27) as cited in the former reference]. Privatization as a form of functional decentralization has led other economists to believe that the developing countries would stay in the hands of the public sector, at least for the foreseeable future, even though that might not be the most efficient means of achieving sustainable development (Ikenberry, 1990) (Todaro, 1989) (Kone, 1990) (Low, 1990) (Ramanadham, 1989).

4.7: Paradigms of Decentralized Development

During the period 1981-1992 there emerged three major paradigms of development all of which considered territorial decentralization to be the main apparatus of development. The first was "development from below" (bottom-up and periphery-inward) from Stohr and Tylor (1981). The second was the "strategy of reversals" from Chambers (1991). The third one, which is an extension of

the previous two, was "development from within" from Taylor and Mackenzi (1992).

4.7.1: Development From Below (Bottom-Up and Periphery-Inward)

This strategy was introduced by Stohr and Tylor (1981) and was influenced by the dependency school ideologies. The latter believe that the deterioration of development in the underdeveloped world is an outcome of the expansive and exploitative development of the industrial market economies and that the status of underdevelopment is not a temporary stage leading to development, but a continuous one resulting from the pattern of centre-periphery exploitative relationships (Street and James, 1982, p.681).

Moreover, Taylor (1992) argued that the concept of "development from below" had its roots in the populist ideas of the nineteenth and early twentieth centuries as defined by Roberston:

" articulate the need to secure the cooperation of "ordinary simple people" in reformist endeavour, and usually do so by making the generous assumption rest with them (the people)- rather with other more clearly identifiable groups and interests like businessmen" (Roberston, 1984, p.222).

The concept of "development from below" was also introduced by anthropologists such as Pitt (1976) before Stohr's introduction to his paradigm.

Pitt (1976,P.4) argued that development in conventional theory or practice comes from above, is externally imposed

by government bureaucracy, and has minimal links with and knowledge of the recipients (people). Thus, development from below should be internally generated from the grass roots as represented by rural villages away from the power and influence of the development bureaucracies.

According to Stohr, there are five major dimensions of policies which have to be followed and these form the cornerstones of the Stohr paradigm: territorially organized basic-needs services; rural and village development; labour intensive activities; small and medium size projects; and the application of a notion of technology which can permit the full employment of regional human, natural and institutional resources on a territorially integrated basis (Stohr, 1981, p.43).

In "development from below", development has a different meaning which depends on two factors, space and time. As a result it should be achieved through spatial mobility and diversity rather than unitary solutions dependent on externally imposed functional goals such as privatization and free-market oriented policies.

" There are many concepts of development depending on the natural and social environment of different communities and the development over time of specific culture and institutional conditions. In fact, these represent major factors of development potential and should not be subordinated to the short-term pressures of any externally dominated or anonymous market mechanism" (Stohr, 1981, p.44).

After assessing the experience of the "export-led" model in the South-East Asian countries (the four tigers)

Chenery and his colleagues (1986) concluded that the export-led model cannot be the only alternative strategy to be followed in developing countries because of the different institutional factors characterizing them. For example, larger countries can implement an import-substitution strategy (ISI) while smaller countries can specialize in exporting. This is the same pattern advocated by Stohr (1981, p.62). However, similar to Stohr, Chenery and his colleagues (1986) doubted the effectiveness of pursuing a market mechanism in developing countries because of "structural rigidities" and "limited substitution possibilities" (Chenery, et al., 1986, p.339).

A similar conclusion about the rigidities of market mechanism could be found in Colclough who argued that, "the market itself is precisely the problem to be addressed" (Colclough, 1991, p.21).

Nevertheless, the criticism of the paradigm of development from below arose from its lack of feasibility under the international conditions which prevailed then.

As Stohr (1990, p.22) said there were three major doubts about the feasibility of "development from below". The first concerned the weak position of most local economies (i.e, few resources and scale economies) to absorb the international wave of economic restructuring processes. The second was political in that local communities did not possess enough power or momentum successfully to confront

the powerful international and government elites. The third reason was the lack of evidence of successful local or regional development initiatives whether from developing or developed countries.

Moreover, Taylor (1992, p.234) categorized the criticism into four major groups; inadequate specification of the theoretical frame of the paradigm; failure to specify the necessary and sufficient conditions for such development to emerge; the need to explain what was a theory of policy; and finally criticism from the planners in developing countries who saw the theory and its ideas as just another example of theories developed in the North and applied to the South.

However, the paradigm has recently restored its credibility because of increasing evidence of successful locally based development initiatives which have emerged from developed and developing countries⁸.

4.7.2: The Strategy of Reversal

During the period 1983-1991 Chambers developed what he called "A Counter-ideology of Reversals". In his words

"It is a counter-ideology which takes as its starting-point the conditions and priorities of rural people, especially the poorer, and the problems and opportunities which they face; and it leads to a different constellation of prescriptions" (Chambers,1991, p.265).

⁸The evidence of successful local initiatives in Europe presented by Stohr (1990), in Sub-Saharan Africa by Taylor and Mackenzi (1992) and in Latin America by Stephen (1991).

This strategy is complementary with rather than a substitution for other strategies. However, it counters the neo-Fabian school, where the state should do more, and the neo-Liberal school, where the state should do less, in that they are subscriptions for development from above, centre-outwards and top-down.

While functional decentralization was the main weapon of the two earlier schools, the counter-ideology of reversals was based on territorial decentralization. "Near the core of this paradigm is decentralized process and choice" (ibid, p.276). Its main focus is the rural poor and the realities of field administration (i.e, poorly paid staff).

Thus, the reversals of the strategy are; location, learning, explanation, values, control, authority, and power. In sum, its aims are to put people on the periphery first (ibid, p.264).

This strategy suggested functions for the state which ultimately have to be based on the experience of the state, and its openness to indigenous pluralism and the mix of ideas. The state functions proposed by Chambers are the following; firstly, maintenance of peace and the democratic role of law; secondly, provision of a basic infrastructure and services; and thirdly, the management of the economy (ibid, pp.267-268).

As far as privatization is concerned, the strategy

emphasised the importance of studying each case independently rather than attempting to generalize from the experience of other countries. However, it is always important to ask the questions; who will be better off and who will be worse off?

The Technical Centre for Agriculture and Rural Cooperation (CTA) in its monthly bulletin (Spore) noted that privatizing the supply of fertilizers in Senegal resulted in a sharp decline in fertilizer use, thus jeopardizing land fertility (Spore, 1992, p.2). Likewise, the privatization of state monopolies in the field of vaccines and the treatments of animals left poor livestock producers in Chad unable to pay the high charges demanded by the private sector. Commercial dealers have taken over the most prosperous sections of the agro-chemical supply business in Africa which has resulted in many isolated sections of the rural areas being neglected. Similar problems arose after the privatization of the African marketing boards in Mali. The big business men deal with capitalist farmers while small farmers are unable to get access to the market (Spore, 1992, p.2). The uncontrolled policy of privatizing state monopolies as well as state lands in the agricultural sector has been shown to represent a risk for peasant farmers who are often vulnerable and who have to learn to adapt to the new deal (ibid, p.4). Thus, identifying gainers and losers should form an important part of any privatization programme.

In summary, the aim of this strategy is to transform what is called the "unable state" into "enable state", so that equity and efficiency can be achieved through reversal and diversity. A further aim is equitable development through raising the voice of the poor and enabling them to become more efficient in the sense of mobilizing their creative energy. Providing incentives for long-term self-reliant investments by the poor should make it possible for development to become more sustainable.

Thus, as development becomes more complex and divergent, so it becomes more stable and sustainable. There is no simple medicine such as "getting the price right" or "rolling back the state".

4.7.3: Development From Within

This strategy was introduced by Taylor and Mackenzi in 1992. It is based on both previous paradigms of development. The heart of the strategy is;

"Development from within argues for the maximum utilization of the resources of a territory primarily for the satisfaction of the inhabitants of that territory. This include both the physical and human resources of local communities" (Taylor, 1992, p.245).

In addition, the strategy has based its framework on actual experience drawn from eight case studies in rural Sub-Saharan Africa. As a result they argue that the strategy can be a "strategy for survival" in cases of short-term survival needs as well as a "strategy of development" when it emerges as a complete institutional

building process which mobilizes the capacity of local people.

The basic goal of this strategy, as with the previous two, is "to allow local people to become the subject, not the object, of development strategies" (ibid, 1992, p.257).

Such cases are in contrast with policies such as privatization because the latter minimizes people's capacity to one characterized by a rational actor without any space and place dimensions. Privatization focuses more on isolated individuals than on social interaction within local communities. For this reason "development from within" cannot be understood through systemic processes, as is the case in privatization because the moral considerations appearing though the case studies at the micro-level are incompatible with rationality at the macro-level⁹.

Development from within demonstrates a local community's understanding of communal bonds and constructive collective identities based on time and place. Such a relationship is difficult to quantify through a mathematical model without simplification of the various

⁹Rationality is considered in the context of the free-rider problem. Olson(1965) argued, that the strategically rational individual will be a free rider. "Unless there is coercion or some other special device to make individuals act in their common interest, rational, self interested individuals will not act to achieve their common or group interest" (Olson, 1965, p.2).

factors operating in reality. However, it could be well assessed through analysis of the general results on the ground.

The question to be asked is what are the key components of "development from within"?

There are two key components to this strategy, participation and territoriality.

In participation, the paradigm adopts Goulet's participation concept (1989) as both goal and means.

"It is not induced from above but is generated from below by the populace itself; it can also be generated by the catalytic action of some external third agent. In terms of the timing of the involvement, it begins with the first step of Goulet's sequence: the initial diagnosis of the situation" (Taylor, 1992, pp.236-237).

Goulet (1989, p.167) listed the sequential moments of participation as follows: initial diagnosis of the problem and conditions, selecting action possibility; organizing; choosing the specific steps in the implementation; self correction or evaluation during implementation and debating the merits of further mobilization.

Goulet (1989) and Taylor (1992) agree that different kinds of development require different forms of participation. Thus, in the case of survival, action will not depend on permeation by the state or a bureaucratic organization. On the other hand, if the notion is "people centred development", there will be a need for a form of participation in which the elites play no active role

(territorial decentralization). In the case of growth-oriented policies, such as privatization and free-market policies which are based on a top-down approach, participation will be imposed and monitored in order to achieve the functional goal of growth with a major and active role for the elite.

The second key component is the territoriality concept. This includes "place and social relations and power interaction which take place within the bounded space" (Taylor, 1992, p.241). However, territory has a variety of scales, the most efficient one being the "local scale" where people can interact and coordinate within their life-space bounds (these include values and morals within given institutional conditions).

Such a scale of local territory may appear to be small and not to utilize the advantages of economies of scale. However, Olowu (1989, p.205 as cited in Taylor, 1992, p.242) has provided quantitative evidence on the average population for existing local government units in Africa which encourage "localness"¹⁰.

The problem of equating participation with decentralization, as perceived by governments through the delegation of their powers to local level organizations,

¹⁰In Zimbabwe, the average local unit was about 6,000 people. In countries such as Kenya (136,090), Tanzania (166,386) and Ghana(187,692), the local unit is larger than in countries such as France (1,320), USA (2,756) and Italy (2,717).

is that it does not mean empowering people or meaningful participation by the rural or urban masses. Instead, the distribution of political and economic power determines the magnitude of participation because it is based on a top-down approach to development (Ghai, 1990, p.216) (Ingham, 1993, p.1810). The value of participation should be derived by empowering the people who are deprived and excluded. This requires that local organizations are democratic, independent and self reliant (Ghai, 1990, p.216). In this way decentralization will be an approach to human development, where participation denotes the cornerstone.

Territorial decentralization will be judged on whether participation is authentic empowerment of the poor or a manipulation of them. This would require an examination of the "elite domination hypothesis" (Echeverri-Gent, 1992, p.1409). It is known that local elites also deprive the poor of the fruits of territorial decentralization. Griffin (1981) argued that

"it is conceivable, even likely in many countries, that power at the local level is more concentrated, more elitist and applied more ruthlessly against the poor than at the centre"(Griffin, 1981, p.225).

This hypothesis is correct if poor people remain dependent upon the elite for employment, loans and gaining access to the administration.

That is why privatization cannot be discussed within the same fabric of territorial decentralization because the first enhances the power of the elite itself, while the

latter needs to heighten people's consciousness and awareness in order to raise their voice.

In summary, this strategy is a combination of "development from below" and the "strategy of reversals". All three demonstrate the importance of the territorial dimension in decentralization. Thus, privatization is seen as a functional decentralization which, when imposed on people in a conventional top-down and centre-outward approach, may not imply participation. It is a continuation of the policy of monocentric reliance on traditional large scale market-driven, large-organization and central-government initiated development processes.

4.7.4: The Differences Between Functional and Territorial Decentralization

Within the context of privatization it is important to summarise the major differences between it and territorial decentralization according to the views of the previous development strategies.

-One of the differences lies in the origins of the ideas and initiatives. Privatization originated in the West and is initiated from the capital city whereas territorial decentralization is initiated from the villages or towns.

-Privatization may include participation while in bottom-up territorial decentralization, participation is an essential component. Without it decentralization loses its

meaning.

-The implementation process of privatization is relatively rapid once decisions have been achieved, whereas in territorial decentralization it is gradual, local, and at the people's capacity and pace.

-The evaluation of the process itself is external in privatization while it is internal and continuous in territorial decentralization.

-A further difference is the standardization of privatization policies which in territorial decentralization are diversified.

-The scope of privatization is narrow and limited to the achievement of quantitative goals (i.e., technical efficiency, profitability), but in territorial decentralization there is more scope for institutional growth, which can often be qualitative.

-The beneficiaries from privatization are the dominant elite in the market while in territorial decentralization all the people benefit, particularly the poor.

- A final difference is the level of knowledge or what Banuri (1990) called "epistemological decentralization". Territorial decentralization will depend on an approach to

knowledge which depends on shared nature and experience whereas in privatization the knowledge forms are alien and can generate counterproductive ends (Bardhan, 1993, p.636). Uphoff (1993, p.609) called the medium between the public sector, which represents a centralized approach of development, and the private sector or the market (functional decentralization), the third sector (local level) in which the grassroots organizations (GROs) operate and provide the best approach to rural development.

The characteristics of each approach are represented in table (4.1).

What distinguishes the third approach from the other two is that it emphasises the collective choice of individuals based on participation in voluntary agreement which is sanctioned through the social pressure exercised by other members or in the case of free riding, by a single member. Such characteristics cannot be found in the top-down approach (state sector) nor in the market approach to development which are based on individual choice (Nugent, 1993, p.624).

The impact of the organizations emerging from each approach will lead to a negative-sum game in the state sector, a zero-sum game in the market, and a positive-sum game in the case of GROs (Uphoff, 1993, table no.2, p.612).

Table 4.1
Alternative Approaches to Rural Development

	First approach	Second approach	Third approach
Principal mechanisms	Bureaucratic organizations	Market processes	Voluntary associations
Decision makers	Administrators and experts	Individual producers, consumers, savers and investors	Leaders and members
Guides for behaviour	Regulations	Price signals and quantity adjustments	Agreements
Criteria for decisions	Policy and best means to implement it	Efficiency-maximization of profit and/or utility	Interests of members
Sanctions	State authority backed by coercion	Financial loss	Social pressure
Mode of operation	Top-down	Individualistic	Bottom-up

Source: Uphoff (1993, table 1, p.610).

The reason for such results, as Uphoff perceived, derives from the advantages of the "spirit of voluntarism" which can lower operating costs and serve the community. Similar results were recorded by Van De Kragt and his colleagues (1988) when they noted that people who act for the benefit of others even when costs were imposed on them are "rational altruists" who base their decision on the size of the external benefit as well as the costs. For example, if there is pressure on government budgets, as is the case currently because of the IMF stabilization programmes, government organizations may not have the financial capacity to serve local needs. Nor do market organizations, because the latter through their drive towards profit maximizing may provide inferior quality products, as is the case in many developing countries.

Thus, the viable alternative will be GROs which can be the medium for people-centred development.

Cernea (1991) argued that "people-centred" projects cannot be limited to projects only in the social sectors (education, health, family planning, nutrition, and the like). People must be central to all projects. Gaude and Miller (1990, p.212) noted that such projects need to be sustainable because sustainability is a necessary condition for replicability. This is contrary to the privatization experience in the majority of developing countries which have resulted in depriving the poor of the capacity to voice their demands.

UNDP (1993, pp.77-78) noted that the devolution of power to the local level increases economic efficiency because projects and services are planned, implemented, monitored, and evaluated by local people who understand their needs and priorities better than the central level. It also increases political freedom and enhances democracy if it is initiated within a package of institutional reform.

Privatization and free-market oriented advocates are in contrast mainly concerned with increasing revenues and using them efficiently at the local level within the context of decentralization. Rondinelli and his colleagues (1989, p.70) said that "user charges are likely to become a major source of financing local services in developing countries". Although it may be important to raise local government revenues to finance expenditure, their generalization to primary health care and education will

"deter many of the poorest users and cause considerable hardship- while raising relatively little money" (UNDP, 1993, p.73). The assessment of the user charges effect can be derived from the empirical evidence provided by Weissman (1990) in a visit to two public health clinics in one of the low-income areas in Accra (Ghana). He noted that user charges have benefited the rich and crowded-out the poor. In his words;

"A major aspect of structural adjustment policy has been the introduction of health fees to ease budgetary burdens. Those now amount to 12% of the allocated recurrent budget. But according to available data, the use of health services declined in many areas following the introduction of fees in 1985. While utilization increased for the more advantaged populations, the level of use remained depressed among the poorer groups" (Weissman, 1990, p.1627).

Further evidence on the negative effects of enforcing user charges and cuts in the health budgets of developing countries is provided by Martin (1993, pp.128-136).

The difference between the World Bank/IMF vision of functional decentralization, or what Williamson (1990) [as cited in Taylor (1993, p.582)] calls a "Washington consensus", and the human development approach to decentralization can be traced to the following quotation from the UNDP human development report of 1992.

"The World Bank and the IMF must ... assess projects and programmes with a vision that extends beyond economic and financial feasibility. They must take into account the effect such projects and programmes will have on the human being concerned" (UNDP, 1992, p.81).

Wiarda (1992) argued, that western ethnocentric efforts to

promote development in developing countries have contributed to the destruction of the only viable institutions (i.e, family networks, clan and tribal loyalties, religious movement and others) which are the only agencies that might have enabled them to achieve development. He said that;

"The destruction, in the name of modernization, of such traditional institutions throughout the Third World may well be one of the most important legacies that development left behind ... For by our actions and our patronizing, condescending, and ethnocentric efforts to promote development among the LDCs, we may have denied them the possibility of real development while at the same time destroying the very indigenous and ... viable institutions" (Wiarda, 1992, pp. 62-63).

In short, empowering people at the local level might be the only viable alternative for human development during the 1990s. Such development cannot be achieved by a single decision as is the case in privatization but requires commitment to an institutional building process beyond the magnitude and objectives of privatization. This means also that within the privatization programme there is a need for the interests of the underprivileged groups to be articulated at all stages of the divestiture process. Through the promotion of a more open and interactive process an environment can be created which is more conducive to improving public confidence in the state privatization programme and more favourable to its implementation.

Privatization, however, is only one aspect of the solution to the economic problems of developing countries. Others,

such as the reform of SOEs within a context of increasing autonomy and accountability, are further components of such a solution. Instead of withdrawing from ownership of state enterprises, particularly in the social services, the government may decide to subject an increasing number of them to reform and rehabilitation measures.

4.8: Decentralization in Practice

The birth of decentralization ideas in developing countries during the 1970s and 1980s was seen as a partial cure for excessive centralization and as a response to the weak capacity of the centralized state to plan and implement development agenda. Thus, the concept of decentralization was vague, and the results of its implementation in developing countries were received with "guarded optimism", as Rondinelli and Nellis (1986, p.4) called it. This is because some improvement from decentralization was traced in cases such as in Indonesia's Provincial Development Program, Morocco's local government reform, and other partial improvements in Thailand, Pakistan, and Tunisia (World Bank, 1984).

However, the experience as reviewed by the World Bank (1984), Cheema and Rondinelli (1983), Rondinelli and Nellis (1986) put privatization at the end of the decentralization scale, while during the late 1980s, the privatization position has jumped into the lead (Rondinelli et al., 1989, p.72).

Privatization in its current context will not reduce

centralization, increase empowerment and people participation, or alleviate the poverty which is the cancer of developing countries. This is because financial crisis in developing countries following the start of the debt crisis in 1982 provided the international aid agencies such as the World Bank and the IMF with new powers which allowed them to play a major role in the international political economy. Their visions as financial institutions are more related to factors of financial feasibility and solvency. This is symmetric with their organizations' objectives. Thus, it is not surprising that their roles as financial institutions may be in conflict with the capability approach to development. For example, democracy and popular participation may provide further resistance from the poor to policies such as stabilization, structural adjustment and privatization.

Ingham and Kalam (1992) argued that it is the agenda under which the decentralization concept and its impact were introduced during the 1970s and 1980s that is different. While its assessment should be measured within the context of participatory development, the view of its advocates from the World Bank, and other International organizations and their followers took,

"the form of a transfer of authority and responsibility outwards and downwards from the central government, it involved new functions and duties for regional staffs outside of the capital, for local government, public authorities, non-governmental organizations (NGOs) and voluntary organizations. The object was enhanced administrative and economic

efficiency, improved implementation of development programs, and in the best situations, a greater degree of responsiveness to local needs" (Ingham and Kalam, 1992, p.374).

Furthermore, those aid agencies themselves are currently behind the increasing trend towards centralization because of their provision of aid and conditional loans to central government linked with their policy advice and design of the current reform policies in many developing countries, particularly the poor which lack the administrative ability to design reforms.

The data on decentralization measurements in developing countries represent a major obstacle when assessing the extent of decentralization and its impact on human development. The UNDP Report of 1993 provided different measurements of financial decentralization and social expenditure decentralization ratios in developing and industrial countries.

Table (4.2) shows that there is a wide difference between developing and industrial countries in the expenditure and revenue decentralization ratios. On average the expenditure decentralization ratios are below 15 percent in developing countries, except for South Korea, Zimbabwe and Nigeria.

In Latin American countries, such as Chile and Brazil, the ratios are below 10 percent while for other Sub-Saharan African countries and Pakistan the expenditure ratios are below 5 percent.

Table 4.2

Financial Decentralization in Local Governments
in Selected Countries (percentage)

Country	Year	Total Expenditure decentralization ratio*	Modified Expenditure decentralization ratio**	Revenue decentralization ratio***	Financial autonomy ratio****
<u>Developing countries</u>					
Korea, Rep. of	1987	33	n.a.	31	99
Zimbabwe	1986	22	29	17	58
Nigeria	1988	17	n.a.	n.a.	n.a.
South Africa	1988	10	11	10	70
Chile	1988	8	10	6	61
Brazil	1989	7	14	1	33
Morocco	1987	6	n.a.	8	108
Paraguay	1989	4	5	3	88
Kenya	1989	4	5	7	134
Pakistan	1987/88	4	n.a.	6	100
Costa Rica	1988	3	n.a.	3	123
Ghana	1988	2	n.a.	2	71
Cote d'Ivoire	1985	2	n.a.	2	115
<u>Industrial Countries</u>					
Denmark	1988	45	51	31	58
Finland	1989	41	43	29	63
Sweden	1989	37	42	30	78
United Kingdom	1989	26	31	16	55
Czechoslovakia	1990	26	27	19	61
Ireland	1989	23	28	10	33
Switzerland	1984	22	24	22	87
USA	1989	21	26	16	65
Hungary	1990	19	21	11	53
Austria	1990	16	18	17	89
Canada	1989	16	18	11	53
Australia	1990	5	6	5	83

Source: Countries been selected from the UNDP (1993, table no.4.2, p.69)

- * Local government expenditure as a percentage of total government expenditure.
- ** Local government expenditure as a percentage of total government expenditure less defence expenditure less debt servicing.
- *** Local government revenue as a percentage of total government revenue.
- **** Local government revenue as a percentage of local government expenditure.

Local governments in industrial countries, by contrast, spend a larger proportion of the total expenditure. Except for Australia (5 percent), the expenditure decentralization ratios of other industrial countries ranged between 15 and 45 percent. Even with the deduction of military and debt servicing expenditure in the modified ratios, developing country indicators of expenditure decentralization do not improve significantly. Similar indicators could be found in the revenue decentralization ratios of developing countries where local governments do not possess the power to raise revenue from local taxes. The only decentralization ratios in which developing countries appear to be equal to those in the industrial ones are those regarding the financial autonomy ratios (about 60 percent). However, in reality the difference is immense because local government autonomy has to be derived from its expenditure ability. This ability is narrow in developing countries and consequently a high financial autonomy does not mirror the size of local spending as a proportion of total government spending, but rather the percentage represents 60 percent of an already small percentage of spending.

Other indicators of decentralization which relate to human development such as social expenditure at the local level revealed that developing country local governments spent only about 5-6 percent from the total on social spending while in developed countries the ratio was around 25 percent (UNDP, 1993, p.71). As has been argued earlier the

decentralization of social spending may be more efficient at the local level but despite that developing countries governments still control a large proportion of expenditure. However, the decentralization of expenditure at the local level does not in itself secure the provision of local needs. The experience of building prestigious projects such as expensive colleges and hospitals, as was the case in Pakistan in 1985, may provide counter-evidence of the rocky road to decentralization (ibid, p.74).

There is a need to empower the poor and enhance the democratic polity at the local level before the delegation of power can proceed. This requires government commitment rather than government withdrawal from the scene.

The overall assessment of decentralization practices in developing countries undertaken by UNDP found that there was not much evidence of full devolution; where there was some kind of decentralization, it has generally increased efficiency and better priority spending ratios. However, decentralization requires state intervention to reduce the disparities between poor and rich regions as well as some sort of mechanism to remobilize the structure of power towards the excluded people (UNDP, 1993, p.83).

Although there is pessimism rather than optimism about the benefits of decentralization in developing countries, the growing body of literature on the subject proves that decentralization and democratization in the context of enhancing people's capabilities is gaining ground.

Scholars such as Slater (1989), Marglin and Marglin (1990), Ingham and Kalam (1992), Uphoff (1993), Lipton and Nugent (1993) are only a few examples among many.

4.9: The Effect of Privatization on Technological Choice and the Informal Sector

The proponents of privatization and free-market policies argued that market prices, through competition in internal and international markets, would help producers to choose the "appropriate technology" for the nation.

If we investigate the recent technological history of developing countries, it will reveal that the economic policies in general and industrialization policies in particular, adopted from the 1950s until this day, have led to a deterioration in the use of the concept of "appropriate technology" or "orientation". Imported technology from the West following the adoption of the ISI has left developing countries with huge problems in continuing the use of such technology. Most of the projects have been a kind of "Master-Key project" where the employees have no idea about their maintenance. This has led to more dependence or reliance on the West, and more financial expenditure in terms of foreign exchange, which is rarely available in low-income countries. Thus, the results are more debt and more unemployment because most of this technology is capital intensive in its nature and origin. Nevertheless, this does not mean that segments of this technology have not contributed positively to

development efforts in developing countries, in particular, in the areas of communication and marketing. The question is: why does privatization in its current international context not provide an incentive to induce and enhance the adoption of appropriate technology in LDCs?

It is well known that efficient technology for a producer means a cheaper and more technically efficient process. So, allowing developing countries to make technological choices within an integrated international market (globalization) will logically induce the producers in developing countries to purchase the form of technology that matches the factors of cheapness and technically efficient *in order to compete internationally*. According to the argument presented by the World Bank (1991, pp.88-90) the integration of developing countries within the global economy means that producers in LDCs will continue to choose Western technology. The recent experience in Eastern Europe and the former Soviet Union is a positive witness to this.

Even the arguments of the organization theories, such as the Principal-Agent theory, X-efficiency theory, and the transaction costs theory will induce producers to favour technologies which reduce agency costs, opportunism and shirking which mean less employment of the labour factor in production. Such logic cannot help in the alleviation of the poverty problems in LDCs.

An important impact of globalization is derived from the

unequal competition between traditional products and similar imported goods from cheap origins such as the products from East Asian countries. Hirschman (1984a) recognized such a phenomenon.

"During the first phase of export expansion in countries of the periphery an important effect is, not the creation of new industries to satisfy rising consumer demand, but the destruction of established handicraft and artisan activities as labour is withdrawn from them for staple production and as new imports of consumer goods compete successfully against them" (Hirschman, 1984a, p.66).

Where centralization as well as commercialization has led rural people into the trap of dependency, participatory development would produce "self-reliance" and foster self-sufficiency in local organizations. The essential component in this process is "learning by doing" as well as "mobilizing" local resources for more efficient use. There is no shortage of resources, but the question is how to mobilize them? The answer is territorial decentralization which provides economic operators in the local rural areas with the incentives to engage in new activities. This is what Hirschman (1984a, p.75) called the inside linkages. One of the main factors which determines such linkages is the degree of technological strangeness. When this is increased, inside linkages will meet with special difficulties. Hirschman (1984a), Cohen and Uphoff (1980), Uphoff (1991), Banuri (1990), Stohr (1981) and Taylor (1992) as well as others all argued that the importance of using appropriate technology is that it is far more efficient than using an alien technology. This

is because the latter attenuates linkages and establishes cultural resistance itself. Capital-intensive technologies and modernized ones do not by themselves produce development; people produce development. However, not all modernized technologies are irrelevant to the development of developing countries. Those concerned with infrastructure and communication can help efficiently in supporting the indigenous development effort.

The main factor is how people can control technology because this is the condition for inside innovation. Without it, the existing path of dependency and the loss of the knowledge would continue. Indigenously based knowledge could have a major contribution to sustainable development because it is found on the local scale and is more practical than that in advanced countries which reflects the institutional factors of its origin.

The alternative approach to decentralization provides a good opportunity for the use of appropriate technology.

Through popular participation in decision-making the people would reveal their preferences and ideas subject to deliberation. Inside the production system people who are involved and affected by the production process would utilize the meaning of appropriate technology. Inside linkages would work in two dimensions; the first would be learning from their own experiences how to adopt appropriate technology in the context of controlling it within their environmental, economical, social boundaries and restrictions rather than their adaptation to more

technically efficient, sophisticated, and progressive forms. Innovation would come as a logical result in the second dimension through interaction within the production system. "Need is the mother of innovation" could well apply in this case. The past history of developing countries and their civilization is consistent with such an argument. If a clear profile of accelerating benefits emerges, for the employee in particular and the community in general, innovation would be one of the expected outcomes.

This is consistent with the institutional school argument denoted by C.E. Ayres. He emphasised that the efficiency of technology rests on two factors. The first is that it is an autonomous, self-sustaining process and the second is that the potential for innovation will be enhanced in a respective environment [(Ayres, 1962) as cited in Street and James (1982,P.684)]. This denotes a rejection of the conventional belief that invention and discovery are best explained in market terms. This conclusion stems from the institutional school belief in the progressive evolutionary character of society as well as the technological history of Latin America and Sub-Saharan Africa (Street and James, 1982).

If people and employees were to participate in decision-making, there would be more incentives for them to enhance productivity because such efficiency would promote their well-being as employees in the production system and would enhance the well-being and progress of their community as

well. They share in costs and benefits. For that reason coordination should become a value rather than a strategy for work (Appadura, 1990, p.213). This is contrary to individualism as the outcome of privatization.

Territorial decentralization or devolution recognizes the importance of the informal sector in generating income and employment for the poor. Page and Steel claimed [1984, p.19 as cited in Dessing (1990,P.7)] that micro-enterprises could be highly efficient even though most are unlikely to expand and are not primarily seeking to maximize profit but simply to generate income (self-employment creation).

Streeten (1992, p.98) pointed out that the informal sector, when provided with the right setting, can possess many advantages over large-scale formal sector firms. These are advantages of location, simplicity in the production process, lower costs in local markets, and adaptability and responsiveness to changing demands.

Thus, macroeconomic policies such as free-market oriented policies and privatization would promote large-scale private investments which do not necessarily promote small-scale activities and may even eliminate them.

Furthermore, the contestable market features of free entry and exit and zero sunk costs can be applied to the micro-enterprises of the informal sector rather than to those operating in the formal sector. According to Baumol (1982) contestability gives consumers the benefit of competition

while at the same time disciplining producers as it makes them vulnerable to hit-and-run entry.

Thus privatization as a transfer of ownership and/or control from the public to the private sector or as a functional decentralization should be accompanied by appropriate microeconomic policies and organizations which are necessary to bring micro-enterprise activities into the mainstream of the economic development process. Streeten (1992) called it the approach to "crowd-in" the informal sector. There is a need to look at the development process in terms of building a pyramid which depends on laying down a solid foundation before proceeding to the next level; otherwise, the top-down approach will result in a "shaky tower" (Dessing, 1990). Stein (1992) argued that the liberalization policies proposed by the World Bank and the IMF in Zambia destroyed the small-scale industrial sector. He argued;

"In general the World Bank/IMF approach is unduly exclusionary, internally inconsistent and largely undetermined. While the measures recommended will lead to a decline in import-substituting manufacturing and [State] ownership, these are unlikely to be replaced by the ownership or industry types desired by the World Bank/IMF (export oriented, resource processing, etc). Overall, the policies are likely to deindustrialize, forcing countries into a problematic reliance on resource and agricultural exports" (Stein, 1992, p.86).

Thus, privatization and liberalization policies might lead to an intensification of the disparities between the rich and the poor unless accompanied by a package of reform that brings the informal sector into the heart of the

development process. It is argued that liberalization and privatization would encourage foreign direct investment to increase its inflows to developing countries. The data on global investment reveals that out of \$181.7 billion invested worldwide in 1989, 89.7 percent was invested in OECD and only 10.3 percent in developing countries, of which the most needy Sub-Saharan African countries received only 1.4 percent (\$2.6 billion) [IMF (1990) as cited in Steidlmeier (1993, pp.216-217)]. This demonstrates that international investment responds to profits in international markets rather than to the needs of a country.

The problem, however, is not limited to the factor of investment. Another important one is the loss of knowledge. Even with poverty spreading in developing countries, the traditional activities in the informal sector were not enhanced because of the loss of knowledge and experience in the informal sector. Banuri (1990) noted that "epistemological decentralization" can solve the problem. This means encouraging a new approach to knowledge which emphasizes its shared nature. Alien technologies and alien notions of knowledge have contributed to a distortion of people's capacity to control the technology from one side and to innovate from the other.

Even if we assume that technological progress will accompany privatization, as the latter's advocates have

argued, privatization is by no means the only path to technological progress. At the national level, public enterprises and publicly subsidized private firms can be employed as effective motors for technological change and for the indigenizing of technology as was the case in Brazil and South Korea respectively (Taylor, 1993, p.586). Likewise, at the local level, the importance of specific learning will contribute to the overall effort of development which will enhance people's capacity to control their destiny.

4.10: The Necessity of Coordinating the Efforts For Development

Development requires a coordination of effort at the national, regional, and local levels. The government and its agencies could supply the local community with what Hirschman called the "outside linkages". The supply of public goods is necessary to complement the effort at the local level to achieve sustainable human development. In this case the state is invited to provide an infrastructure such as power, transportation, irrigation systems, and services such as disease and pest control, education and health. This invitation to the state is a requirement because local people cannot supply such goods individually or collectively.

An empirical study of this issue conducted by Anand and Ravallion (1993) examined the comparative effects on the infant mortality rate in Sri Lanka of providing direct

health services through the government and that of increasing income through growth.

The study revealed that an increase of one rupee in Sri Lanka government health expenditure per capita would reduce infant mortality by 1.1 deaths per thousand which is 22 times more than the impact from a similar increase in average income (Anand and Ravllion, 1993, p.146).

The state still possesses an effective role in decentralization. This is contrary to the role assumed and assigned to the state by the advocates of privatization and free-market oriented policies.

There exists a crucial role for the state in providing a suitable social, economic and political environment in which local initiatives and local self development could flourish [UNCRD (1989, p.21) as cited in Taylor (1992, p.255)].

Another important role is to maintain peace and the democratic rule of law which can be achieved through providing equality and justice. Legal decentralization and devolution of power are the major factors that can contribute effectively to the delivery of such responsibility.

Providing equal access for the poor through their supply of basic goods and food at affordable prices is another responsibility for the government.

The state also has the important role of providing training programs to produce an educational outcome suitable for the economy's needs. That would require a shift in educational policies so as to provide the respective knowledge to the rural poor.

However, to reduce the impact of bureaucracy public goods can be provided at a level lower than the central government (e.g. regional government). Nevertheless, there would still be the need to create a connection between the different agencies at different levels. Communication as a means of understanding and the feed-back of information would be important as well.

It is difficult to argue that territorial decentralization by itself would guarantee an equal distribution of political power or real empowerment. Neither could empowerment guarantee voice. This is what is called the "political patronage hypothesis" (Echeverri-Gent, 1992, p.1412). In this hypothesis, public participation would require a process of interest representation mediated by agents such as political parties, NGOs or other organizations. In such a case there might be a contradiction between the interests of the two. According to Echeverri-Gent (1992, p.1414), political competition is an essential mechanism for the effective operation of participation.

It is essential to understand, as Ingham and Kalam (1992, p.384) state, that the traditional decision-making structure can be different from place to place and from

time to time. Thus, greater decentralization does not necessarily mean "power to the people". But, the evolution of democratic and independent organizations at the local level may support the evolution of a healthy institutional setting for popular participation.

Riddell argued that decentralization constitutes three major changes in direction; "power, knowledge and information handling to be decentralized away from the central government and recentralized outward from local government" (Riddell, 1985, p.225). Thus, coordination and cooperation would be the most important elements contributing to such a required change.

The task of reforming SOEs in the literature of privatization often assumes that privatization is the goal of reform, and often the concept of reform has been used as a synonym for privatization (Galal, 1991) (Shirly, 1990) (Shirly and Nellis, 1991). The danger in the proposed privatization policies stems from the fact that it has become a matter of belief rather than one of a number of alternatives. It must be recognized that privatization, if pursued "within the wrong framework and without a human development purpose in mind", will fail to achieve the objective of development defined as increasing human well-being (UNDP, 1993, p.51). Furthermore it would mean no accountability to the people while the poor would be worse off and the rich better-off.

Participation through privatization has to consider two

facts, firstly the constraint imposed by government design and implementation policies for privatization (e.g., budgetary deficit) and secondly the need to make enterprises accountable to the people through the government as a competent third unbiased agent or through the people's representatives (e.g., democratic institutions). If the voice option can be used effectively, there would be a prospect to reform SOEs and to make them more accountable and people-oriented.

4.11: Conclusion

Throughout the preceding sections, people in communities have been presented as the cornerstone of development. Their diversity can be used as a source of well-being. Advocates of privatization are eager to use market forces and private ownership as the only source of growth. Impersonalization of human relations and choices, through the demand and supply forces, could be ensured. There is no territory for the rational actor; instead there is only the market.

As the market is restricted in developing countries and the institutional factors are different from those prevailing in the West, there is a need to introduce the place factor in any development strategy. That is because functional alternatives such as privatization will not change the coercive power of the interest groups whether they are operating through market tools or through state power. Both would lead to a concentration of income and

wealth, both deny the poor their entitlement and choice to improve their capability. Also, both eliminated institutional factors from their calculations because the considerations are limited to efficiency and growth through the "trickle-down" principle.

The question addressed by the chapter is how can privatization empower people when the present bargaining power is in the hands of the elite?

The chapter suggested that privatization might enhance the participation of the poor and the underprivileged if it was designed and implemented within a framework that can enhance workers' participation in decision-making and ownership as well as other people who are excluded from participation in the market place (such as the low income groups). However, the experience of developing countries, as shown by the chapter, gives little evidence of such intention.

The alternative then is devolution or territorial decentralization. There are two key principles on which this alternative can work, participation and linkages. Participation is defined as

"the organized efforts to increase control over resources and regulative institutions in given social situations, on the part of groups and movements hitherto excluded from such control"[Wolf (1983, p.2) as quoted by Goulet (1989, p.165)].

Thus, participatory development would imply a dependency on local initiatives through grass root organizations rather than a bureaucratic structure. As a result, accountability would be enhanced because local people have

a special interest in sustainable development.

Privatization is a "crisis driven policy" while participatory development is a strategic setting based on community rules and values and their collective capacity rather than an individual one.

The proponents of privatization equate economic freedom with privatization or private ownership. In participatory development, economic freedom should be defined as a decision-making input to the degree that one is affected by the outcome of an economic choice. In the case of privatization, unequal ownership of property is inconsistent with "equality of opportunity". It is the notion of property rights rather than participation because the scale of the first determines the size and activation of the latter.

Thus, the dominance of the private property concept will reduce, if not diminish, any interest in community projects and as a result low participation in decision making on which the choice concept stands. It is a case of ignorance and isolation.

The problem of privatization in developing countries is that it promotes the culture of silence and people will not participate in their humanization. Poor people will be marginalized in the name of growth and denied the opportunity to choose in the name of "equal opportunity". This is because the privatization experience in developing countries treats people as objects of development while participation and democracy through decentralization would

have an educational impact. It transforms the poor from objects of development to knowledgeable subjects of progress. Within this context participation would be seen as a goal and as a means for achieving sustainable development. It increases the internal cohesion and solidarity of local communities in order to reduce their dependence and increase their self-reliance. This is consistent with Uphoff's conclusion that

"government and technical agencies seem to prefer delivering benefits at a time and place of their own choosing in order to keep control. In the process, however, there is no assurance that they will be delivering the most needed benefits, or even correct ones" (Uphoff, 1991, p.491).

Finally the chapter suggests that development may mean decentralization which certainly means participation. However, privatization will not necessarily assure that. It will depend closely on the design and the implementation which cannot be severed from the objectives of introducing it in the first place. If privatization within the context of developing countries is to be sustainable and people-centered it has to be a gradual process, relatively crisis-free, untroubled and unforced, marked by the fusion of collective participation from below (e.g., grassroots) and individual participation in the market place. Such an approach will depend exclusively on the commitment of the decision makers and their vision of empowering the people.

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PART II: THE CASE OF JORDAN

Chapter 5

The Jordanian Economy (1952-1992)

5.1: Introduction

5.2: Jordan Prior to 1952

5.3: The First Phase of Development (1952-1972)

5.4: The Second Phase of Development (1973-1992)

5.5: Conclusion

5.1: Introduction

Jordan is a small country which emerged as a political entity in 1921 when the Arab Emirate of Trans-Jordan was established on the East Bank of the Jordan River. In 1946 it became a sovereign monarchy. In 1950, after the 1948 War which resulted in the partition of Palestine and the creation of Israel, that part of Palestine which had been retained in the hands of the Arabs was incorporated into the renamed Hashemite Kingdom of Jordan. After the 1967 War, Israel occupied the West Bank which has remained under occupation until this day.

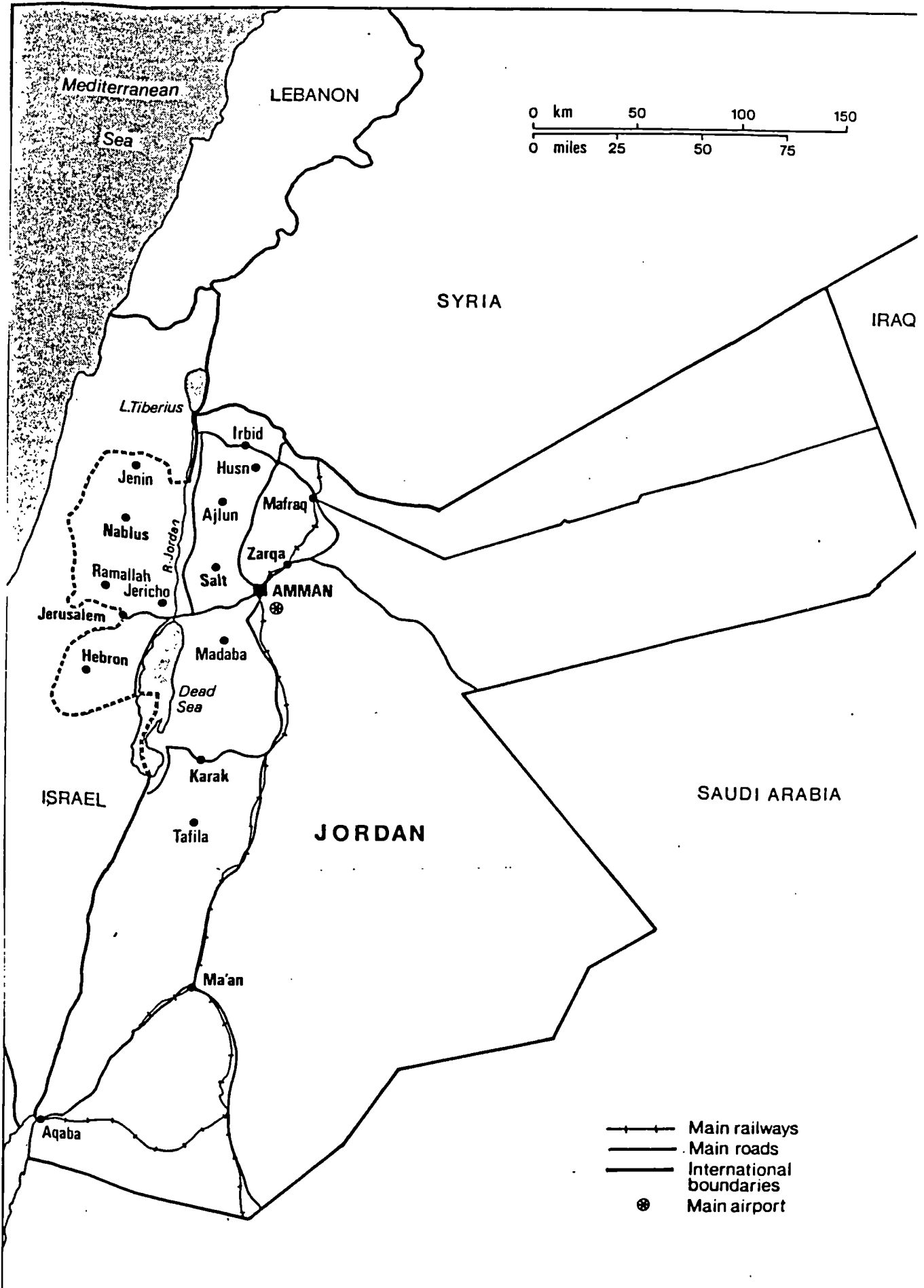
The selection of Jordan as a case study is based on its distinctive economic experience. Since its foundation, Jordan has followed a free-market ideology combined with an export-promotion strategy after 1985 (as advocated by the neo-classical theorists) but it has suffered from deficient development outcome.

This introduction suggests reasons for the negative results of the continuous development efforts in this country. The analysis in this chapter will focus on the characteristics of the Jordanian economy during the last four decades (1952-1992). The questions to be asked are whether there are any specific variables which influence the performance of the economy. Are there any constraints? What is the relationship between the productive capacity of the economy and the country's consumption pattern. Does

unemployment denote a problem for the economy; if yes, what are the reasons? Is there a case of disparity between the regions inside Jordan, and between the income strata. As alleviation of poverty is the objective of economic development as well as the slogan for development economists and institutions in the 1990s, is there real poverty in this country?

All these aspects will be evaluated in this chapter, in order to facilitate the later case study of privatization and development in the country which follows in the next chapter. The methodology employed in this chapter is a holistic one based on investigation into the economic as well as the non-economic factors (history, institutions, politics, etc.) which have played a major role in the different development phases of Jordan.

Jordan Map



5.2: Jordan Prior to 1952

More than 450 years ago, Jordan was one of the Turkish Ottoman Empire colonies. Between 1516 and up to the First World War the area which became Jordan constituted the Syrian province of the Ottoman Empire.

During this period of colonialism the country suffered in the same way as most of the other Ottoman colonies from poverty, illness and illiteracy.

The economy was predominantly agricultural as more than three quarter of the GDP was produced by this sector (Patai, 1958,P.119).

Although agriculture was the main domain of employment farmers were under continuous oppression from three main interest groups.

The first group was the Ottoman authority with its heavy taxation of the farmers on the one side and its army policy of compulsory military service on the other. Both these policies deprived farmers of an important proportion of their money and labour.

The second group was the nomads. The nomads often raided the farmers and either stole whatever they could, and\or demanded from them (farmers) a share in the crops at the time of harvest. Such behaviour was a normal feature of nomadic life, especially as there was no central authority, no police force and no law and order in general terms, to protect the rural people.

The third group consisted of merchants and money lenders.

Those were the main reason for the farmers' permanent state of indebtedness. They often imposed a very high rate of interest (up to 70 percent) on farmers, leaving them unable to escape the states of poverty (Al-Tememi and Bahgat, 1965, p.105).

However, despite such oppression farmers were not able to give up farming during this period because there were no other employment opportunities. Moreover, there existed no infrastructure or public services in the country that could encourage industrial investment to promote the absorption of new manpower. Thus, working in the agricultural sector was more preferable to unemployment.

During the First World War, the Bedouin tribes rallied to the call of the British sponsored Arab revolt against their Ottoman Turkish rulers. From 1918, when the Ottoman Empire collapsed, Great Britain assumed responsibility for the region. In 1921, the British installed Amir "Abdullah bin Al-Husayn" as ruler of the British controlled territories east of the Jordan river. The West Bank, however, was retained under the direct administration of Great Britain.

In 1946, the British mandate ended and as a result, the Hashemite Kingdom of Trans-Jordan was officially established.

During the three decades of British colonialism, the

Jordanian economy was dependent on external aid and subsidies from Britain. This was not a temporary feature of the country then, but it was the starting point in a permanent trend towards dependency on external resources capable of financing government expenditure and investment.

In 1921, British subsidies amounted £60,000 paid annually to the Amir of Jordan. These had increased to £100,000 by the mid-1920s and to around £2 million by the mid-1940s. In a country with a population at the time of around 375,000 people, such subsidies denoted a sizable amount of cash. This led Jordan into a path of development characterised by centralization of power on the one side and vulnerability to external factors on the other.

The 1948 Arab-Israeli War

In 1948, the Arab-Israeli War started. It resulted in the partition of Palestine and the creation of Israel. The territories retained in Arab hands were incorporated into the country in 1950, forming the renamed **Hashmite Kingdom of Jordan.**

The incorporation of the West Bank added a sizable population (around 350 thousand) and cultivable land area (around 25 percent). Thus, the population of Jordan became more than triple the population of Trans-Jordan, but the total arable land was increased by about only one quarter.

In addition to this effect of the 1948 war, there were

other effects on Jordan.

The first effect was the disruption of the transport and marketing links between Trans-Jordan and the rest of the world because almost all of Transjordanian imports before 1948 passed through Haifa Port on the Mediterranean sea. On the other hand, Trans-Jordan sold its major surplus production of wheat and barley in the coastal region of Palestine, or exported it through Haifa port. As a result of the war and its aftermath, transportation costs became a heavy burden on the economy. Imports and exports had to travel north to Damascus and then over the mountains to Beirut, or south to Jordan's only outlay of Aqaba. But, the infrastructure was deficient, lacking roads and transport facilities, particularly to the south (at Aqaba).

The second effect of the war and the heavy transportation costs in particular, was that the economy was forced to establish an industrial base that could serve local needs, which before 1948 had often been met through imports. Thus, the selection of import substitution industrialization as a strategy for development was not a choice but a necessary condition for the survival of the country.

Before 1948 manufacturing industry was practically non-existent. Small scale industries were concentrated in food processing, especially flour milling. Thus, the country was dependent on imported consumer goods to meet local demand.

Another effect of the 1948 War was that the Palestinians, who were more urbanized than the east Jordanians (Transjordanian) helped Jordan to facilitate new businesses and activities which had never been experienced in the country before. The contributions of Palestinian businessmen and their labour force were supported by a protection afforded by heavy transportation costs which ensure sufficient profits for their investment in the industrial sector. New industries were expanded, although power supply was expensive, water was in short supply and there was a scarcity of good quality raw materials.

Most of the industries were concentrated in foodstuffs, building materials and simple household goods (Smadi, 1982).

In the agricultural sector, which was the dominant sector, most of the land areas in east Jordan were small holdings (more than 52 percent consisted of less than 20 ha.). As a result, the proportion of subsistence farming as opposed to commercial farming was greater in east Jordan than in Palestine (IBRD, 1957). The country during the 1940s and 1950s was almost self sufficient in food, particularly, field crops and fruits such as grapes, olives and tobacco. Moreover, both kinds of crops, particularly field crops were the major exports of the country .

On the natural resources side, Jordan possessed only large deposits of phosphate rock and salt. Their main source of energy, particularly in rural Jordan, was wood fuels.

To sum up, Jordan had faced two kinds of colonialism as well as further political instability due to the 1948 War. This led to a new set of socio-economic conditions which characterised the country with special features, difficult to be found in the experience of other countries. In particular, the one which led to the change in the main fabric of the society (Transjordanian and Palestinian), and the other related to the importance of the traditional interest groups (merchants, money lenders, capitalist farmers, tribal leaders, etc.).

Thus, in order to evaluate economic development in Jordan, it would be more appropriate if the 40- year period (1952-1992) covered by this part of the thesis is divided into two main periods of study, the first (1952-1972) and the second (1973-1992). However, it is important to stress that the study will employ statistically available data from both primary and secondary resources.

5.3: The First Phase of Development (1952-1972)¹

5.3.1: The Structural Change of the Economy

The population of Jordan in 1952 was about 1.3 million of which more than 50 percent lived in rural areas. Such a distribution could be explained on the one hand by the dominant agricultural base of the economy and on the other

¹.It is to be noted that most of the available and reliable data of the Jordanian economy started to be published in the 1960s rather than the 1950s. Thus, the statistics in this chapter often start from the 1960s.

hand by the slim industrial base during this period. In addition, with minimum infrastructure, housing problems, unreliable public services and few employment opportunities, there were no major attractions to encourage large scale migration to the capital, Amman. Despite that, the capital city of Amman was the major business centre in the country. Merchants and government bureaucrats in Jordan, particularly after the 1948 War, were mainly Palestinians because they were more educated and urbanized than the inhabitants of Trans-Jordan. Moreover, after the incorporation of the West Bank, Jordan's revenues from tourism had increased. As a result the services sector after the 1948 War became more important for its contribution to the GDP than the agricultural sector.

5.3.1.1: The Agricultural Sector

5.3.1.1.1: The Share of the Agricultural Sector

As figure (5.1) shows, there was a declining trend in the contribution of the agricultural sector to the GDP during this period. However, this decline in agriculture during the process of structural transformation was not unique to Jordan but rather

"a tendency obviously driven by powerful forces inherent in the development process, whether in socialist or capitalist countries, Asian, Latin American, or African, currently developed or still poor" (Timmer, 1988, p.276).

This natural fall in agricultural contribution should not

be treated as a "black box". Instead we need to focus on the context of decline historically and through the relationship between government policies and the role of agriculture in structural change.

While its share was about 35 percent in 1952, agricultural sector contribution to GDP in Jordan declined to less than 10 percent in 1972.

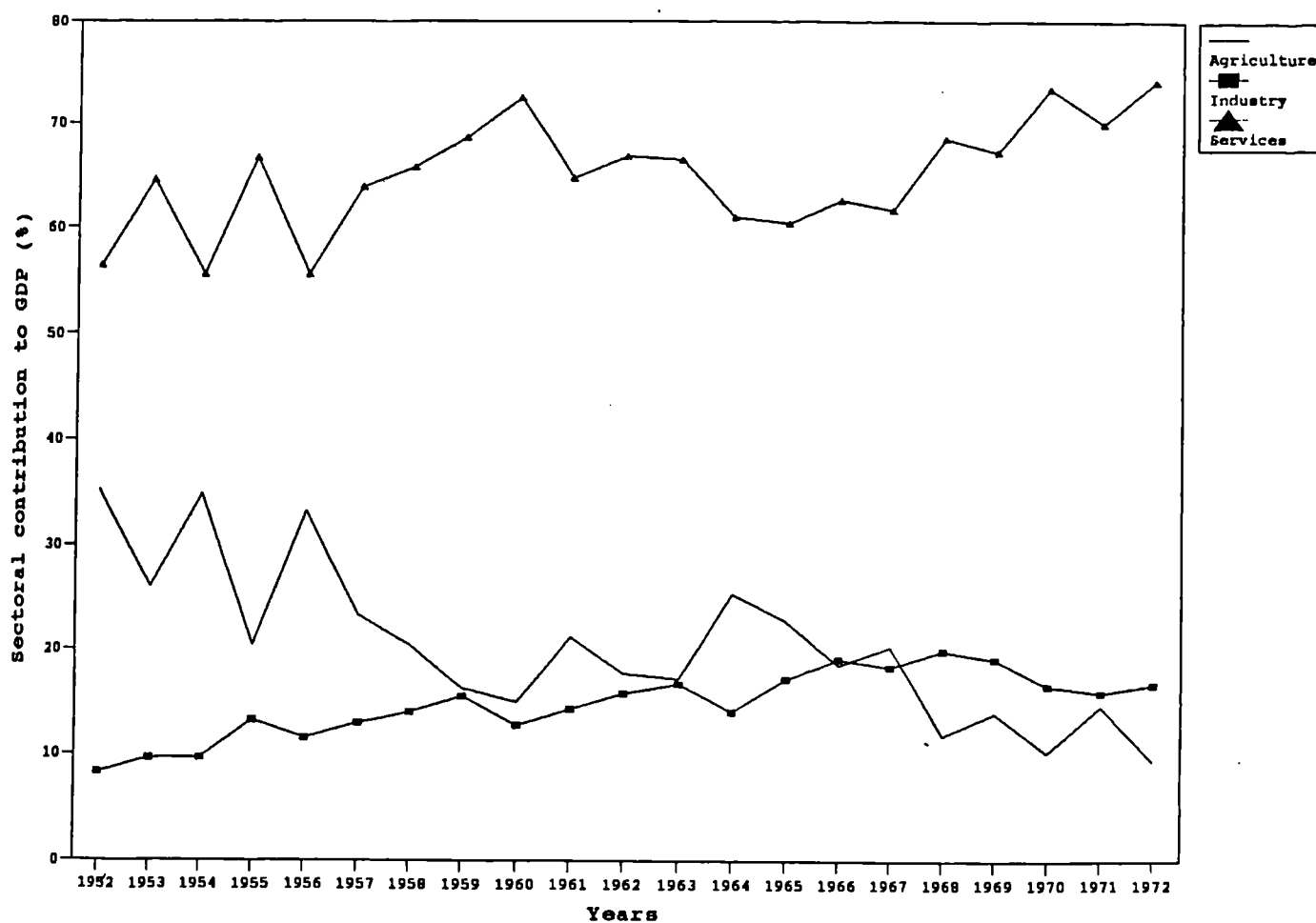
The country's agricultural production fluctuated sharply because of changes in rain levels and weather conditions in general.

Nevertheless, the major deterioration during this period was caused by the 1967 War between the Arabs and Israel which resulted in the Israeli occupation of the West Bank. This event deprived Jordan of more than a quarter of its agricultural output.

Although the agricultural share was about 23 percent on average during 1952-1967, it declined to less than 15 percent after the occupation. During that period vegetables and field crops were the main products of the agricultural sector. Figure (5.2) shows that field crops production during 1964 was more than 430 thousand tons, while it declined after the occupation to less than 150 thousand tons.

The occupation of the West Bank in 1967 had a greater effect on the production of vegetables and fruits in the country than on field crops production. However, in Jordan, as mentioned earlier, good harvests are often dependent on the weather and on the rain factor in

Figure (5.1) : The Sectoral Contribution to GDP in Jordan
(1952-1972).

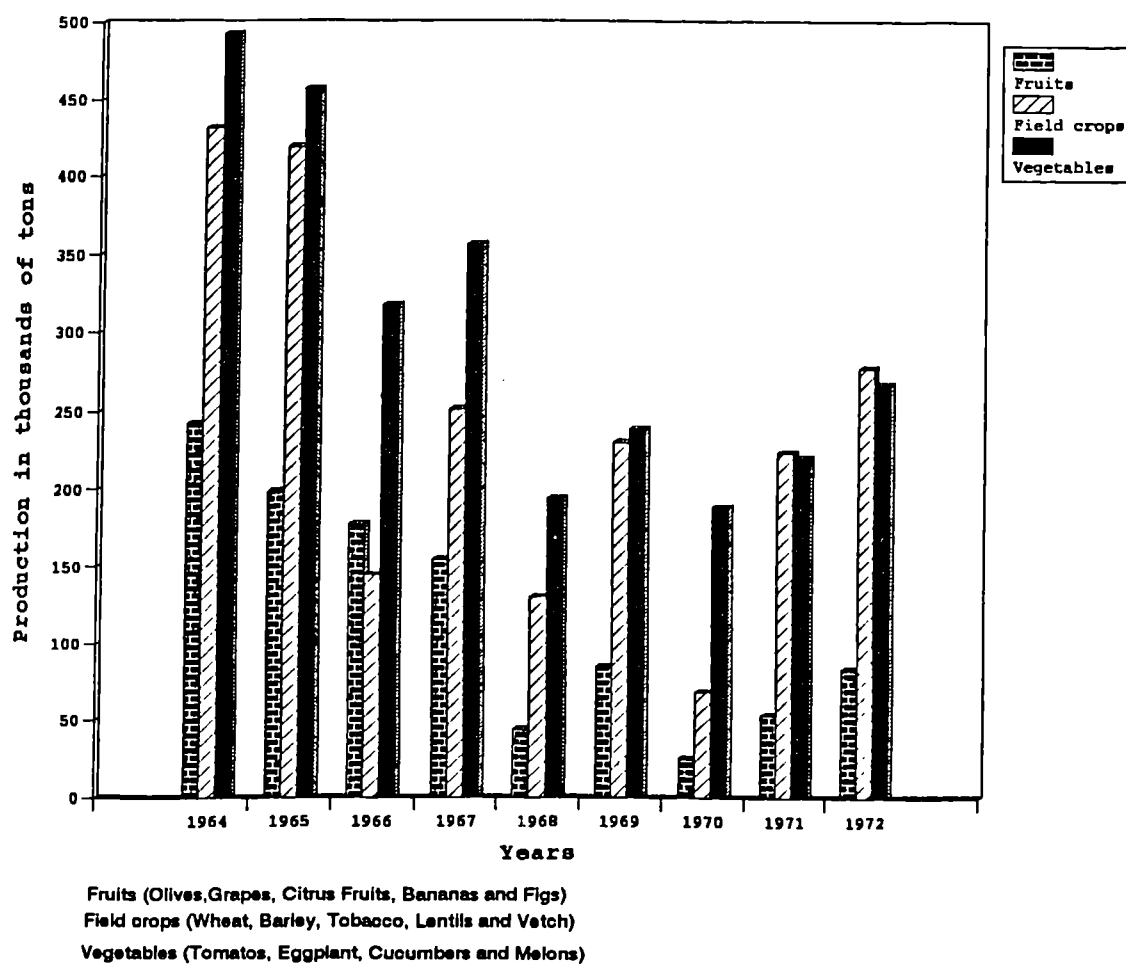


Source: Calculated by the researcher employing the data in

-United Nations and Department of Statistics (1977)

-Central Bank of Jordan (1989, table no.47, p.58)

Figure (5.2): The Changes in the Production of Main Agricultural Crops Groups in Jordan (1964-1972).



Source: Calculated by the researcher employing the data in Central Bank of Jordan (1989, table no. 45, p.56).

particular.

Another reason for the agricultural problem was government policies towards this sector. Such policies were not effective, even before the occupation of the West Bank in 1967, because more emphasis was placed on industrialization. The provision of public services and infrastructure to the major urbanized cities coincided with a general neglect of the agricultural sector and small farmers' needs in particular. Moreover, although irrigation is the main problem, government provision of irrigation water was only concerned with the supply of water to the existing irrigated areas (i.e. East Ghor Canal project 1959-1961 and the other projects in the Jordan valley) (Smadi, 1982, p.16).

Consequently, while the areas cultivated with field crops were about 85 percent in 1956, this percentage reduced to about 73 percent in 1965. On the other hand, land dedicated to the cultivation of vegetables and fruit trees increased from around 5 percent and 10 percent in 1956 to 11 percent and 16 percent respectively in 1965 (FAO, 1967, p.50).

Another important phenomenon is the structural change of the working force in Jordan. As Figure (5.3) asserts, the dependency rate in Jordan is relatively high, about 5:1 . This means that the participation rate which determines the size of the work force was on average about 20 percent of the population. Another unique phenomenon in Jordan was

the decline in the size of population in 1968 due to the occupation of the West Bank. In other words, the occupation left the country with 1.4 million people in 1968, a decrease from 2.1 million before the invasion in 1967.

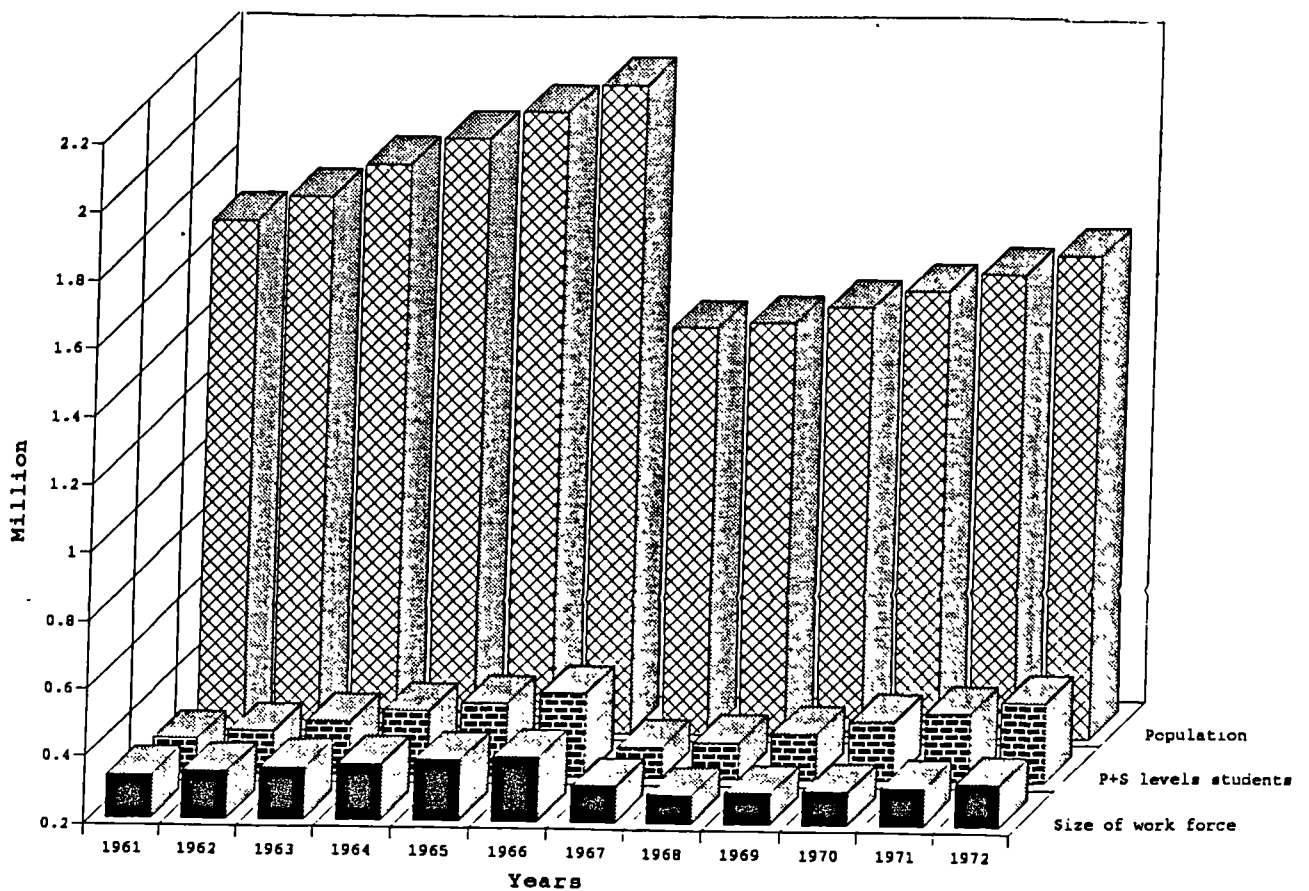
Despite that, during 1952-1972, the participation rate pattern did not change due to two factors. The first is the population structure; half the population was under the age of 15. The second factor was the increasing rate of schooling; 17.8 percent [Primary (P) + Secondary (S)] during 1961. This increased to about one quarter of the population by 1972.

On the sectoral level, while more than 50 percent of the work force were farmers or workers in the agricultural sector during the 1930s, the agricultural work force in 1968 declined to about 22 percent, and to 17.3 percent by 1972 (Ibrahem, et al., 1989, p.74). This major shift in the distribution of the work force was attributable to different factors (such as education policies, credit distribution, powerful interest groups, government pricing policies,..etc).

5.3.1.1.2: Land Tenure and Land Reform

One of the major factors determining the degree of efficiency of the agriculture sector in Jordan is land tenure. Prior to 1956, the tenure of much but not all state land which constituted 31 percent of the total land (called miri land) was on the musha'a system. In other

Figure (5.3) : The Size of Population, Schooling and Employment in Jordan (1961-1972).



Sources:-

- The population data from; Department of Statistics (1991, table no.2, p.19) and Ibrahim et al. (1989, table no. 2.1, p.28).
- The number of students data from; Ministry of education, The Statistical Education Yearbook, several issues.
- The size of work force from; Ministry of Labour, Annual reports, several issues.

words, the lands were held in common and individual rights were based on shares of the total not in specific parcels. The land was redistributed every two to nine years. Thus, there was security in tenure but no continuity on the same piece of land.

In 1957, the government embarked on a program called "Land Settlement" in order to determine and register the traditional rights (IBRD, 1957, p.126). However, such a programme was not introduced to establish communities on the land or to achieve land reform. Rather, because ownership rights are important for traditional social values, the purpose was to reduce conflicts between the tribes as well as to attract the settlement of the nomads in the south for security reasons. Thus, there was no economic significance or purpose behind the programme. On the contrary, most of the land users were not their traditional owners. This privatization of state land has led to a rapid transference of the land to speculators on the one hand and to unequal distribution of lands on the other.

This institutional change could be regarded as a solution in Jordan to the problem of the "tragedy of commons"². The tragedy of commons can be overcome by the substitution of a system of property rights instead of communal rights. However, the establishment of an effective system of

² The tragedy of commons is the deterioration in the quality of common resource that resulted from unregulated behaviour of self-interested utility maximizing individual. For further discussion see; Brown, C.V. and Jackson, P.M. (1992).

property rights requires substantial transaction costs in designing and implementation which the government could not bear. It relied on traditional rights as a way of decreasing the transaction costs of the government. However, this led to unequal distribution of wealth and income among different individuals and groups.

The question is why this solution was more preferable? The answer is, because the alternative solution was an external intervention by the government which brings excessive costs of monitoring and enforcing rules and regulations on land tenure. This solution was more costly than the first. Also it did not provide any settlement to the nomad problem. However, the failure in the design and implementation of the first solution has contributed significantly to the deterioration of the agricultural sector in Jordan.

5.3.1.2: The Industrial Sector

In the industrial sector, the country followed an import substitution industrialization (ISI) strategy as well as resource based industrialization (RBI). However, the ISI path was at that time a necessity rather than a choice of strategy. In other words it was a reaction to the high transportation costs of imported goods from abroad as well as the dramatic increase in the size of the market due to the high number of refugees. Both factors contributed to the expansion of this sector. Another factor was the availability, following shortages before 1950, of skilled

manpower (mainly Palestinian).

According to the World Bank mission to Jordan in 1957, the number of industrial establishment employing more than five workers was 421 establishment in 1954. They employed a total of 8200 workers with an average of 19 workers per establishment. The total capital invested in was 4.3 MJDS and its gross output was 7.2 MJDS, so the capital/output ratio was 0.6 which is low. Such a ratio is consistent with the kind of industries which prevailed at that time (food industries, wearing apparel, wooden products, non-metallic minerals product, detergents, weaving & knitting, beverages, tobacco, bus & trucks bodies and blacksmiths). However, there were no statistics available on the size of the informal sector which constituted the bulk of this sector and was mainly dependent on a handicrafts (IBRD, 1957).

In addition, government protectionist policies encouraged the building of an infant industrial base. The industrial sector in Jordan during this phase of development was limited but growing. Its share of GDP, which had been about 8 percent in 1952, rose to about 15 percent in 1972. The industries were concentrated mainly in foodstuffs, clothing, non-metallic mineral products and wooden furniture.

As Jordan possesses limited mineral resources, phosphates and potash were the only major natural resources to receive heavy investment. The government undertook direct

investment in those minerals in order to increase its revenue in terms of foreign currencies. However, the private sector participated in financing and implementing large scale projects, including cement, the oil refinery and expansion of phosphate production facilities. During this period, "big is beautiful" was the prevailing ideology in development thought, particularly for this kind of industrial project. Economies of scale, forward and backward linkages were patterns to be followed through big projects, in order to provide a big push towards the industrialization of the economy.

What were the other main economics concern of the government at the time?

The government's main concern was the weak infrastructural base of the economy, and the need for construction of public utilities. Roads and housing services were a real problem due to the influx of a large number of refugees (360,000) into the country (due to the 1967 War) which resulted in a huge burden on the Jordanian economy.

5.3.1.3: The Services Sector

As figure (5.2) reveals, Jordan's services sector is the most important sector of the economy. Jordan has always been a country of trade and transit, as is evident from the ruins of Petra. So, the era of modern transport came with the opening of the Hijaz railway in 1904-1907. In other words, in the services sector, the country

mercantile base (traders and businessmen) particularly after 1950 served the expansion of this sector. In addition, government investment in transportation, telecommunications and public utilities, mainly in the urban areas, had helped significantly in the domination of this sector during 1952-1972. Also, the expansion of the banking system and the establishment of new development banks as well as commercial banks had contributed to give the large share for this sector in the country's GDP.

In 1952, the contribution to the GDP of the services sector was 56 percent. This increased to more than 70 percent by the end of this period of study. Moreover, the real annual growth rate of the income of the services sector was more than double the rate of growth in the agricultural sector during the fourteen-year period (1952-1966). However, such service sector growth declined after the 1967 War due to the decline in tourism, workers' remittances and other services.

5.3.2: The Openness of the Economy

The Jordanian economy during 1952-1972 had the features of a modestly open economy. As table (5.1) illustrates, the degree of the economy openness [ratio of (exports + imports) /GNP] during the period 1964-1972 was between 39 percent and 50 percent.

Jordanian imports during the period 1952-1966 had grown at an annual rate of 10.3 percent from 17.2 Million Jordanian Dinars (MJDs) in 1952 to 68.2 MJDs in 1966. The trend

continued during 1967-1972 when the annual growth rate increased to about 11 percent from 55 MJDS in 1967 to about 95 MJDS in 1972 .

Table 5.1

The Economy Openness Ratios and the Size of Trade Deficit in Jordan During 1964-1972.

Year	Exports MJDS [1]	Imports MJDS [2]	GNP MJDS [3]	Openness ratio ((1)+ [2]/[3]) (%)	Trade deficit ((1)-[2]) MJDS
1964	8.7	53.6	160.6	38.8	-44.9
1965	9.9	56.1	180.5	36.6	-46.2
1966	10.4	68.2	185.7	42.3	-57.8
1967	11.3	55.0	142.5	46.5	-43.7
1968	14.3	57.5	166.4	43.2	-43.2
1969	14.7	67.8	197.4	41.8	-53.1
1970	12.2	65.9	187.0	41.8	-53.7
1971	11.4	76.6	199.4	44.1	-65.2
1972	17.0	95.3	221.0	50.8	-78.3

Sources:

- Exports and imports data from; Department of Statistics (1991, table 19/1/1, p.434).
- GNP data from; Central Bank of Jordan (1989, Table no. 47, p.58).
- Economy openness ratios and trade deficit data are calculated by the researcher.

The imported goods were mainly consumer goods (67%) while the intermediate goods and imported raw materials share was 23 percent and imported capital goods share was only 10 percent (Ministry of Planning, 1986, p.5).

On the export side, the value of exports increased from 1.3 MJDS in 1952 to 10.4 MJDS in 1966 mainly due to the increase in the exports of phosphates and other industrial products. During the years 1967-1971 exports did not increase, but they rose significantly in 1972 to 17 MJDS after standing at 11.3 MJDS in 1967 and 11.4 MJDS in 1971. This significant increase was due to rises in the prices

of exports and phosphates in particular (Jordanian Central Bank, 1989, table no.30).

As a result of the rises in imports and the slackening in trade balance deficit was a feature of Jordan's economy throughout.

The deficit rose as table (5.1) depicts, from 44.9 MJDS in 1964 to 78.3 MJDS in 1972. As a percentage of GNP, its size increased from about 28 percent in 1964 to 35.4 percent of commodity exports.

However, the Jordanian governments have always relied on external aid and transfers from abroad to overcome the deficit.

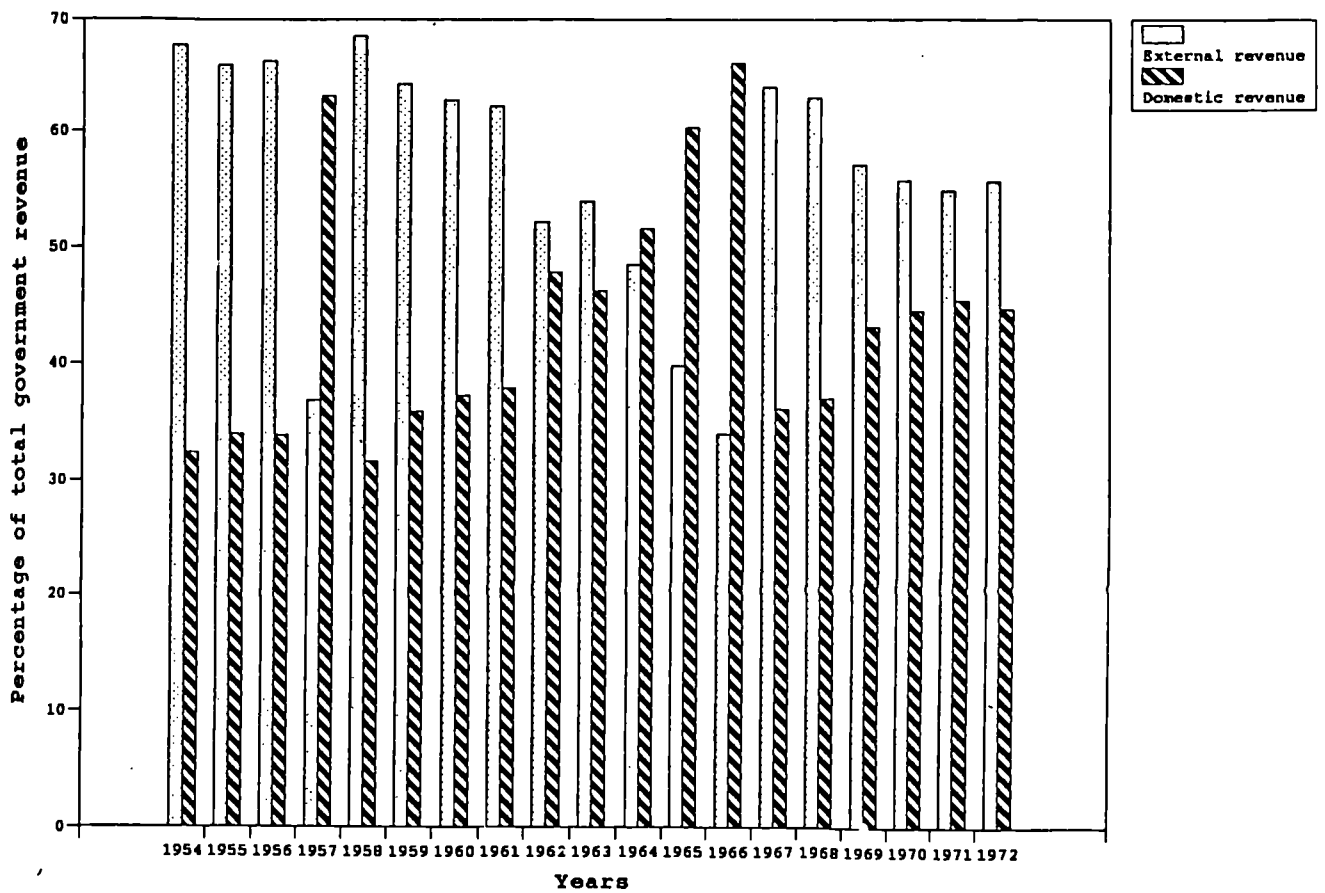
5.3.3: The Importance of External Transfers

Jordanian governments' public finance policies in general were aimed at reducing the reliance of their budgets on external support. Whether this was achieved or not, is the important question.

Figure (5.4) shows that from 1954 up to 1972, the external revenues and assistance to Jordan constituted not less than 50 percent of total central government revenue, except for the years 1957, 1964, 1965 and 1966.

The decline in external support in 1957, mainly from Britain, was due to the 1956 War on the Suez Canal between the allies (Britain, France and Israel) and Egypt which led Britain to stop aiding Jordan. Consequently, Egypt, Syria and Saudi Arabia signed a ten-year treaty with Jordan to supply it with money and arms to compensate for

Figure (5.4): The Sources of Jordanian Central Government Revenue (1954-1972)



Sources:

- Central Bank of Jordan (1989, tables no.37&38, pp.45-46)
- Ministry of Finance, Annual reports, several issues.

the deficit caused by the withdrawal of the British subsidy. Later, for political reasons, Egypt and Syria discontinued such grants.

The other exceptional period was between 1964 and 1966 when British aid virtually ceased, leading to Jordan's exit from the sterling area. As a result the Jordanian Central Bank was established in 1964 to replace the "Jordan Monetary Board". After the 1967 War and until 1972, central government external revenue was not less than 55 percent of total government revenue.

The question is, what are the major sources of external transfers to Jordan?

There are two main sources, the first is external grants and the second is workers' remittances.

5.3.3.1: The External Grants

As mentioned earlier, the State of Jordan since its existence has been dependent on grants and financial assistance from abroad. In the 1950s, the country received its main cash grants from Britain and U.S.A (IBRD, 1957). The assistance during 1949-1952 was called "the Marshall Plan period". During the period 1952-1972, the amount of grants received from abroad rose from 11.8 MJDS in 1952 to about 44.5 MJDS in 1972. As a percentage of GNP, foreign grants constituted on average about 20 percent of GNP.

The turning point was in 1967 when Arab countries' assistance to Jordan increased because of the War and the occupation of the West Bank of Jordan. Thus, the Arab

countries after their summit in Khartoum (the capital of Sudan) decided to assist Jordan as a frontier state against Israel. Annual grants totalling 40 MJDS were pledged by the three oil-rich countries, Kuwait, Saudi Arabia and Libya (Sayigh, 1978, p.191).

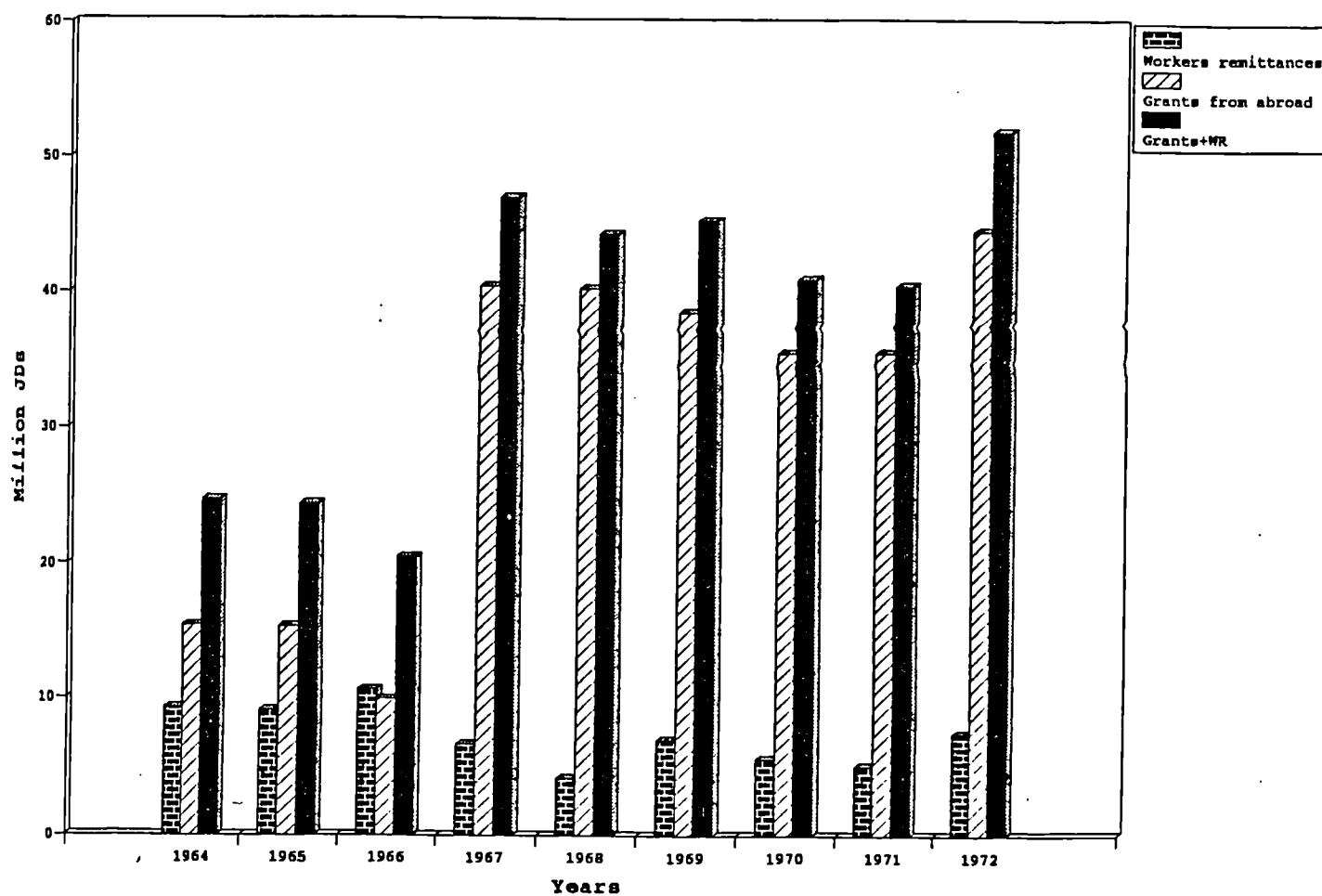
As figure (5.5) reveals, the amount of grants received declined during 1964-1966 because of the stoppage of British aid. But, the financial assistance rose substantially during the remaining years of this phase of development, although it was disrupted by the Jordanian internal disturbances with the PLO during the second half of 1970 . As a result, Arab countries, in particular Kuwait and Libya, reduced their assistance to Jordan, while the United States assistance was resumed after being reduced due to the 1967 war.

However, table (5.2) shows the fluctuated trends of official aid received by Jordan (grants and other development assistance) from the different sources during 1959-1972. It is apparent that Jordan during this period was dependent on unstable external assistance in which political factors played the major role.

5.3.3.2: Workers' Remittances

The second important external source of hard currencies to Jordan is workers' remittances. During the period 1959-1972, the number of Jordanians working abroad rose from 60,000 to 145,000. Most of them left the country because of increased demand for their services in the newly

Figure (5.5): Grants and Workers' Remittances Trends in Jordan (1964-1972)



Sources:

- Central Bank of Jordan (1989, tables no. 21&38, p.26 & p.46).
- United Nations and Department of Statistics (1977, pp. 129-131).

Table 5.2
 Official Aid* to Jordan by Source (1959-1972)
 (Million Jordanian Dinars MJDs)

Item ----- Year	total official aid [1]	Arab aid [2]	U.S.A. aid [3]	Other sources [4]
1959	25.14	...	17.32	7.82
1960	25.49	...	18.20	7.29
1961	25.33	...	17.05	8.28
1962	23.47	...	15.48	7.99
1963	22.52	...	15.51	7.01
1964	26.57	4.54	15.03	7.00
1965	26.78	7.34	11.98	7.46
1966	31.44	9.49	13.37	8.58
1967	51.58	37.57	7.62	6.39
1968	53.07	46.25	1.19	5.63
1969	45.79	41.15	1.25	3.41
1970	39.08	33.07	1.38	4.63
1971	35.94	19.11	12.82	3.56
1972	65.96	23.19	35.95	6.82

Sources:-

1- Hammad (1987, table no. 2.7, p.25).

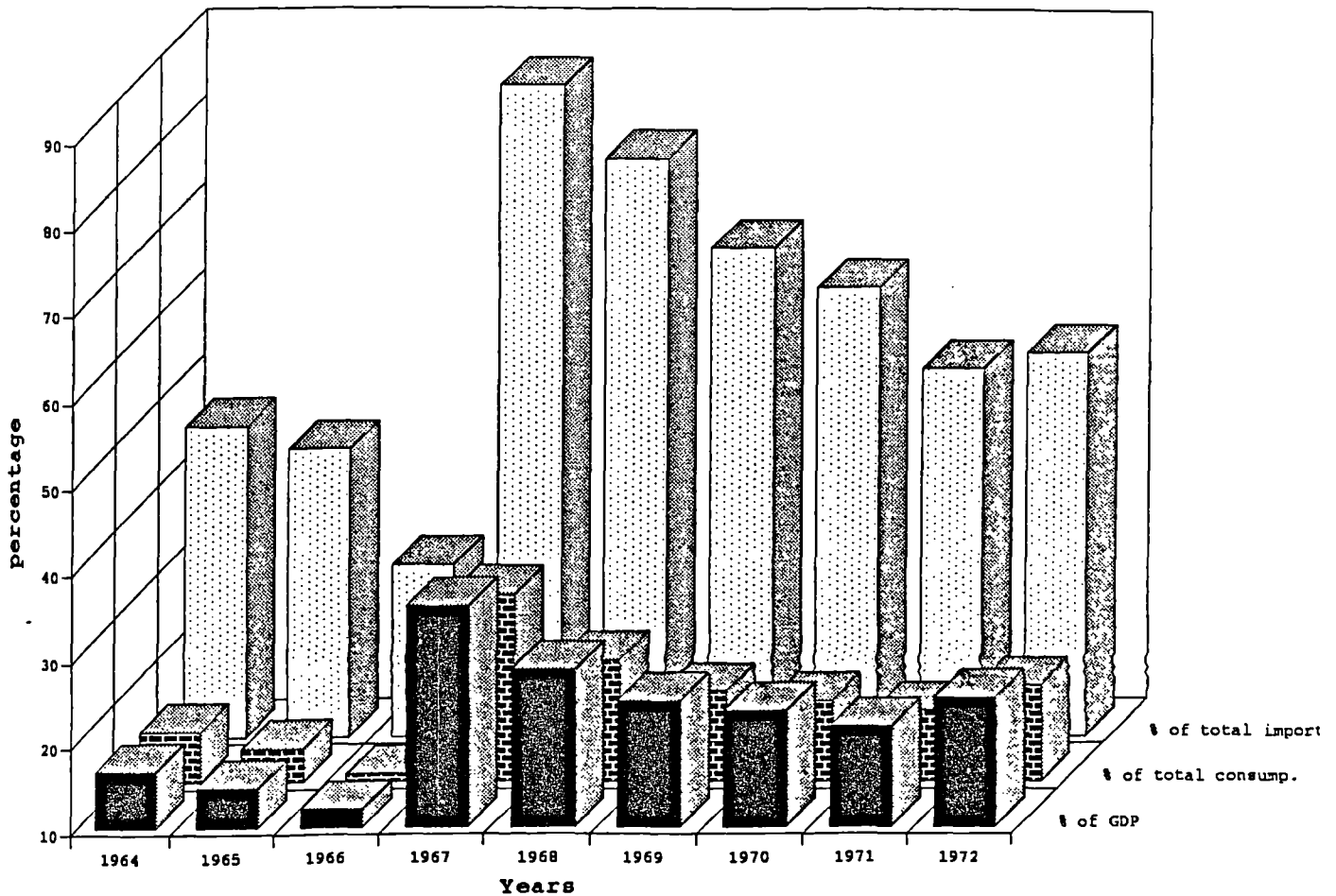
(*) Grants and other development assistance.

emerged Gulf states, in particular Kuwait which absorbed 50 percent of total Jordanian workers abroad in 1961 (Share, 1987, p.32).

Thus, Jordan during 1952-1972 was a labour-exporting country. Remittances amounted to 107 percent of the value of the country's total merchandise exports in 1964. But, such relative importance declined during the last years of this period. The relative importance of workers' remittances relative to the country's export earning declined to 45%, 44% and 43.5% for the years 1970, 1971 and 1972 respectively. The reason was not simply a decline in the number of workers abroad. Since the majority of them were Palestinian in origin, they had stopped transferring money back to Jordan because of the 1970-1971 disputes between Jordan and the PLO. This illustrates the extent to which the Jordanian economy is dependent upon regional politics.

Both grants and workers' remittances during this period were the main factors which contributed to the rise of reserves and as a result enhanced Jordan's import capacity. Figure (5.6) illustrates that their proportion (grants + workers' remittances) to the country's total imports was on average about 58 percent during the period 1964-1972, though their relative importance was of less significance before 1967. Other indicators of their importance are as a proportion of the country's total consumption and of GDP. They constituted about 20 percent of the country's total consumption and 22.5 percent of

Figure (5.6): The Relative Importance of Grants and Workers' Remittances in Jordan (1964-1972).



Sources:

All data are calculated by the researcher employing the following:

1- Grants and workers' remittances data from; Central Bank of Jordan (1989, tables no. 21&38, p.26 & p.46).

2- Total consumption data from; Central bank of Jordan (1989, table no.59, p.59).

3- GDP data from; Central Bank of Jordan (1989, table no. 47, p.58).

country's GDP during 1964-1972.

As a result of this dependency on external resources, the country was more vulnerable to external shocks (i.e.: 1956 war and 1967 war) as well as internal ones because of the complexity of the Palestinian equation and its different effects on Jordan (i.e.: the civil strife in 1970-1971).

5.3.4: Economic Planning

This period in the history of Jordan saw the adoption of planning policies, leading to the first Five-Year Plan for economic development (1963-1967), later altered to the (1964-1970) Seven-Year Plan.

During this period of economic development, the Jordanian government adopted economic planning not as a model to be pursued as was the case in the centrally planned economies, but rather as a symbol of the Jordanian government's commitment to economic and social development. Moreover, the planning document itself was a necessary condition for the receipt of grants and technical assistance from abroad, in particular from institutions such as the World Bank.

This reflects the domination of the idea of planning in the development field during this period. So, Jordan followed the same pattern of development as was advocated by the prevailed theories at the time.

However, as the necessary aggregate data were not available for planners, the planning document consisted of project proposals with no clear strategy. Its assumption

of continuous external budgetary support led the plan to predict an 8 percent annual GNP rate of growth (Jordan Development Board, 1961). As the main assumption proved to be invalid, the plan was replaced by the 1964-1970 Seven-Year Plan.

The goals of the latter plan were mainly a reduction in the trade deficit and a reduction in the dependency on foreign assistance for budget support, a 7 percent annual increase in GDP and a reduction in the level of unemployment (Ministry of Planning, 1986, p.2). These goals were a reflection of the main bottlenecks in the Jordanian economy at that time. However, as the 1967 War disrupted the plan's implementation, and new socio-economic conditions arose, the plan was out of touch with the new conditions. Nevertheless, GDP at current market prices rose during 1952-1966 from 50.5 MJDS to 170.5 MJDS with an average annual increase of 9.1 percent as table (5.3) shows.

During the second period 1967-1972 the GDP decline in the first year affected the performance of the economy to the end of the period, although it rose to 207.2 MJDS at the end of 1972 with an annual growth rate of 7.9 percent during the period.

Another important indicator of real GDP growth was the relative price stability in Jordan during 1952-1966 (Ministry of Planning, 1986, p.2). During the period 1967-1972, however, there was an abnormal increase in the inflationary trend at the end of the period, which had a

Table 5.3

The Changes in the Size of GDP and GNP
in Jordan Between 1952 and 1972.

(MJDs)

Year	GDP	GNP
1952	50.5	51.3
1954	57.0	58.1
1956	74.3	76.2
1958	85.6	87.2
1960	98.3	105.7
1962	118.9	130.8
1964	149.0	160.6
1966	170.5	185.7
1968	156.1	166.4
1970	174.4	187.0
1972	207.2	221.0

Sources:

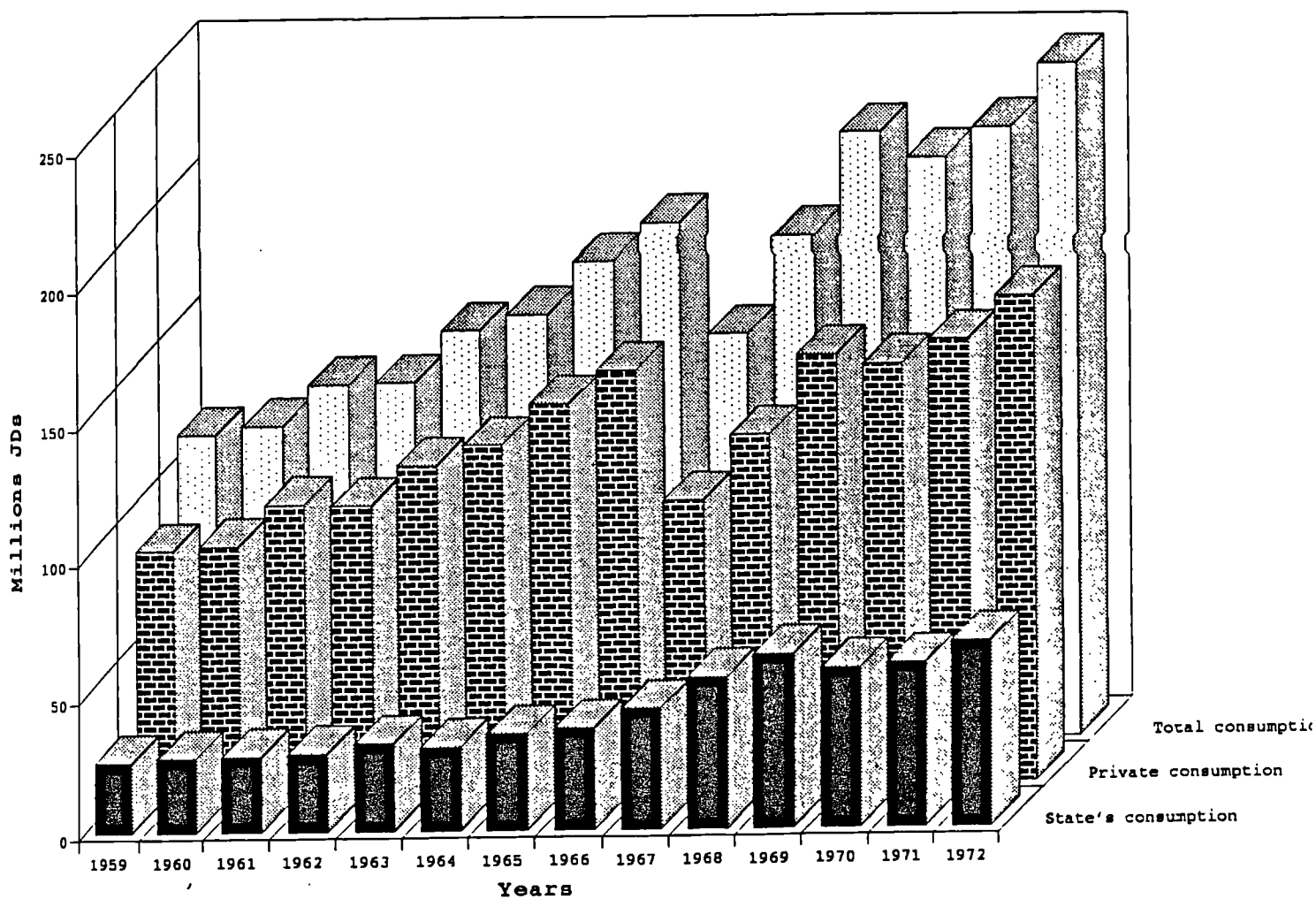
- United Nations and Department of Statistics (1977).
- Central Bank of Jordan (1989, table no.47, p.58).

negative affect on the real GDP annual growth rate. The consumer price index (1985=100) increased from 23.6 percent in 1967 to 33.2 percent in 1972. However, during the period 1967-1972, planning in Jordan was carried out on an ad hoc basis, because of the uncertainties of the time as well as the political and military situation of no-peace no-war (Smadi, 1982, p.29).

5.3.5: Consumption vs. Productive Capacity

Expenditure on public and private consumption in Jordan increased during the period 1952-1966-1972 from 53.1 MJDs to 188.8 MJDs to 245.7 MJDs respectively. Figure (5.7) shows that private consumption in Jordan constituted more than 75 percent of the country's total consumption during the period 1959-1972. But, the important phenomenon in Jordanian consumption was the fact that it was increasing

Figure (5.7): The Sectoral Distribution of Consumption in Jordan (1959-1972)



Sources:

- United Nations and Department of Statistics (1977, pp.110-111).
- Central Bank of Jordan (1989, table no.59, p.59).

more quickly than the country's own productive capacity. It was on average about 107 percent of GDP during the period 1954-1972.

This can be explained by the effect of external transactions. As figure (5.8) illustrates, Jordan consumption during the period 1966-1972 was more than the country's gross domestic product. Another indicator, the relative importance of imports to the GDP, shows that imports constituted more than 38 percent of GDP while exports constituted about 7 percent of GDP on average.

Such measurements can mirror the extent to which the Jordanian economy was a subsidized economy, living far above its means. While per capita GNP was only 40 JDs in 1952, it rose to about 137 JDs in 1972. Such growth in per capita GNP cannot be attributed to the country's productive capacity, but to external cash transfers from outside the economy.

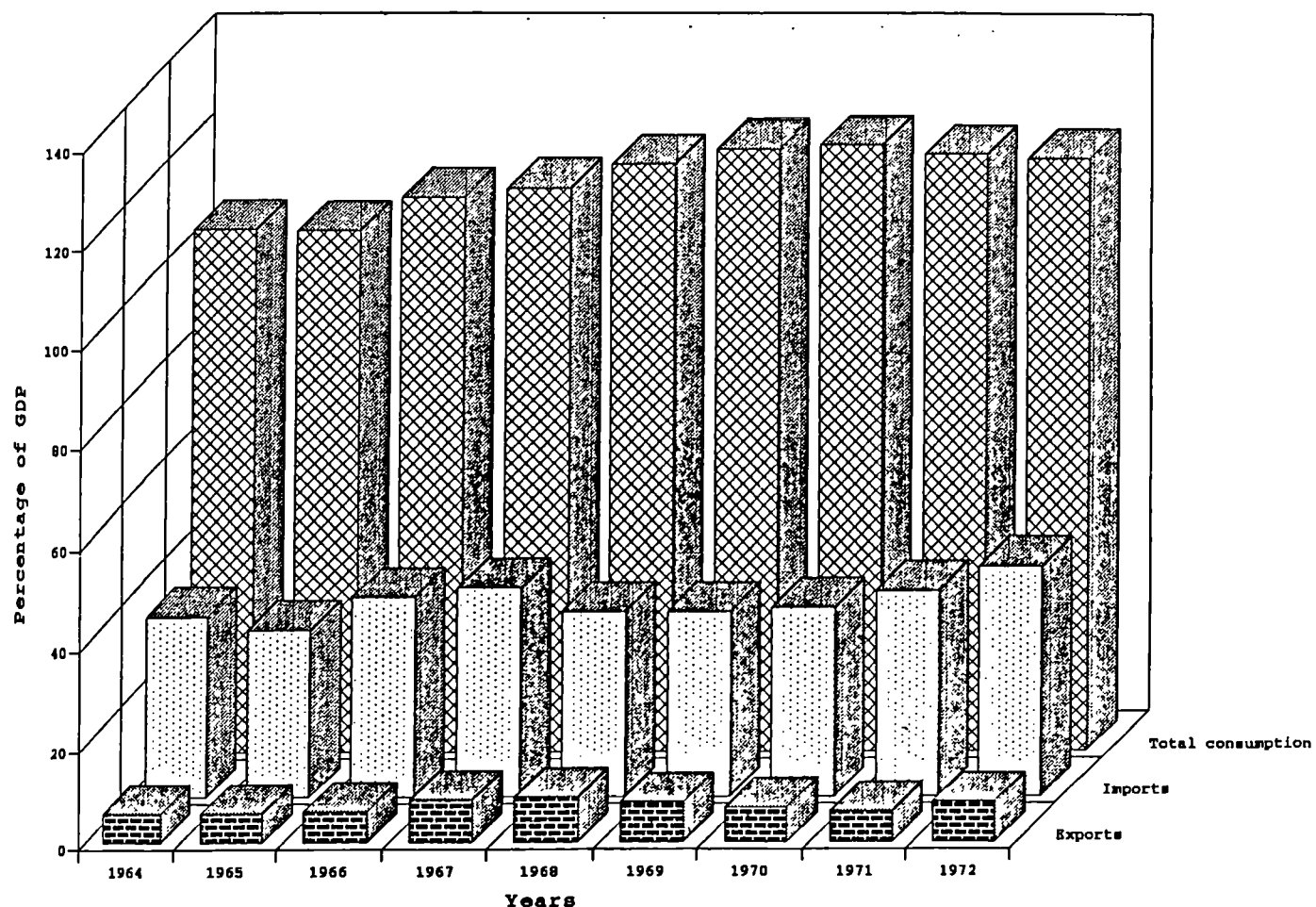
5.3.6: The Social Development Indicators

In order to complete the economic analysis of this period a number of social development indicators need to be considered. This will provide an appropriate basis for an evaluation of the economy's development in a latter stage.

5.3.6.1: The Distribution of Income

During this phase of development there was only one study conducted in 1973 which could be regarded as an assessment of this period of development. The study concluded that

Figure (5.8): Total Consumption, Imports and Exports As Percentage of GDP in Jordan (1964-1972).



Sources:

-All data are calculated by the researcher employing the data in table no. (5.1) and consumption data in the Central Bank of Jordan (1989, table no.59, p.59).

the distribution of individual income was more unequal in the urban areas than in rural areas. About 70 percent of the urban population received only 39 percent of the total urban income, while in the rural areas they received about 43 percent of the total rural income (Al-Assaf, 1979). However, alone, the top 20 percent of urban households in Jordan received more than 50 percent of the total income. A comparison of these results with other developing countries at the time (Jain, 1975) revealed that in Jordan the distribution of income between the different income brackets was better than in India (1967-1968) and Malaysia (1970). However, the distribution of income was worse than in countries such as South Korea (1971), Pakistan (1970-1971) and Sri Lanka (1969-1970).

5.3.6.2: Unemployment Rates

As a result of the limited capacity of the economy, the 1948 War and its aftermath resulted in a rise in the country's rate of unemployment, particularly, where the vast majority of refugees were mostly small farmers who had lost their lands. Another shock to the trends of unemployment during this phase of development was the 1967 War. It caused unemployment rates to reach 9.9%, 11.8%, 13.7% and 14% for the years 1968 to 1972 respectively (Ministry of Labour, 1988).

Thus, at the end of this development phase, the unemployment rate was the highest in the country during the 20 years period (1952-1972).

5.3.6.3: Other Social Development Indicators

Health, educational as well as poverty indicators are essential for providing a complementary view to the progress in the quality of life of the Jordanian people. However, national statistics might not provide a true picture to the uneven distribution of public services and human development in general, particularly between the rural and urban regions.

On the health dimension, the infant mortality rate (per 1000 live birth) dropped sharply during the period 1961-1972 from 151 to about 82 respectively. This could be attributed to the rising standards in the health care due to government spending.

The total fertility rate measurement indicates that in 1965, the rate was about 8 births per women decreased to about 7.8 in 1972. However, this rate varies significantly between the rural and urban areas due to the traditional Islamic values effect which increase in the rural areas.

Life expectancy indicator refer to an estimated age of 45.8 for males and 46.5 years for females in 1961 have increased to about 57 on average by 1972. This increase could be attributed to the government successful efforts in controlling infectious diseases which played a major factor in shortening the average life expectancy rate before the 1960s.

The physician/population ratio increased from 1.8 physician per 10000 population to about 5 between 1961 and 1972. This increase could be attributed to the increasing number of doctors who were graduating from the educational system.

On the educational dimension, Jordan by 1964 had introduced the "Law of Education" no.1 for compulsory education. This law implies nine years of compulsory education for elementary and preparatory cycles in all the regions of the country. As a result the primary school enrolment rate increased to about 87 percent by the end of 1972. Meanwhile, the rate of enrolment in the Secondary schools has reached 38 percent by 1972.

Also, by 1972 the illiteracy rate as a percentage of the population aged (15+) was 67.6 percent.

On the poverty problem, there are no statistics that refer to the case of poverty during the period (1952-1972). However, the only reference to the case of poverty found in the IBRD report on the economic development of Jordan in 1957 stated;

"...without aid from overseas, there can be no doubt that after 1948 the standard of living of one-third to one-half of the population of Jordan would have fallen below the subsistence level"(IBRD, 1957, p.50).

However, the indicators of high inflation rates and unemployment combined with unequal distribution of income can provide a good indicators for the case of poverty in

the country.

To sum up, it could be said that during this period (1952-1972), Jordan followed the same pattern of development adopted by other developing countries at the time, except that of high level of state intervention in the production process. That is to say, planning was adopted although it was indicative. The establishment of central, commercial and sectoral development banks (agricultural bank and industrial bank) was seen to be one of the criteria to measure government commitment. The most important trend was the decline in agriculture's share in GDP and employment. This was consistent with the belief of development economists during this period that (IS) and (RS) industrialization as well as more physical capital accumulation are the main driving forces toward development.

As a result, government policies favoured the industrial sector as well as urban consumers in general against small farmers in the agricultural sector (i.e.; cheap price policy of field crops and subsistence crops in general). Also, the chosen institutional solution to the distribution of land has led to unequal distribution of land and wealth.

What could distinguish the Jordanian case from other developing countries during this period was the political tension and wars which left the country deprived of major

resources on the one hand, and subject to massive changes in the social fabric on the other.

In addition, government investments in infrastructure, health and education was a necessary step toward development. But it was completely dependent on assistance from abroad. Thus, the question is whether the development pattern of high dependency on external resources changed during the next period (1973-1992) or not?

5.4: The Second Phase of Development (1973-1992)

5.4.1: The Characteristics of the Economic Sectors

As already mentioned, the Jordanian economy during the first phase of its development (1952-72) experienced a shift in its structural formulation towards a greater contribution from the services sector. This pattern of structural change continued throughout this phase of development. The question, however, is why such a transformation took place in an economy which had been dominated by an agricultural base only three decades earlier?

5.4.1.1: The Agricultural Sector

In contrast to the contribution of industry and services in the economy, the agricultural sector experienced a continuous decline in its relative importance. While its share had been about 9.3 percent and about 13 percent in

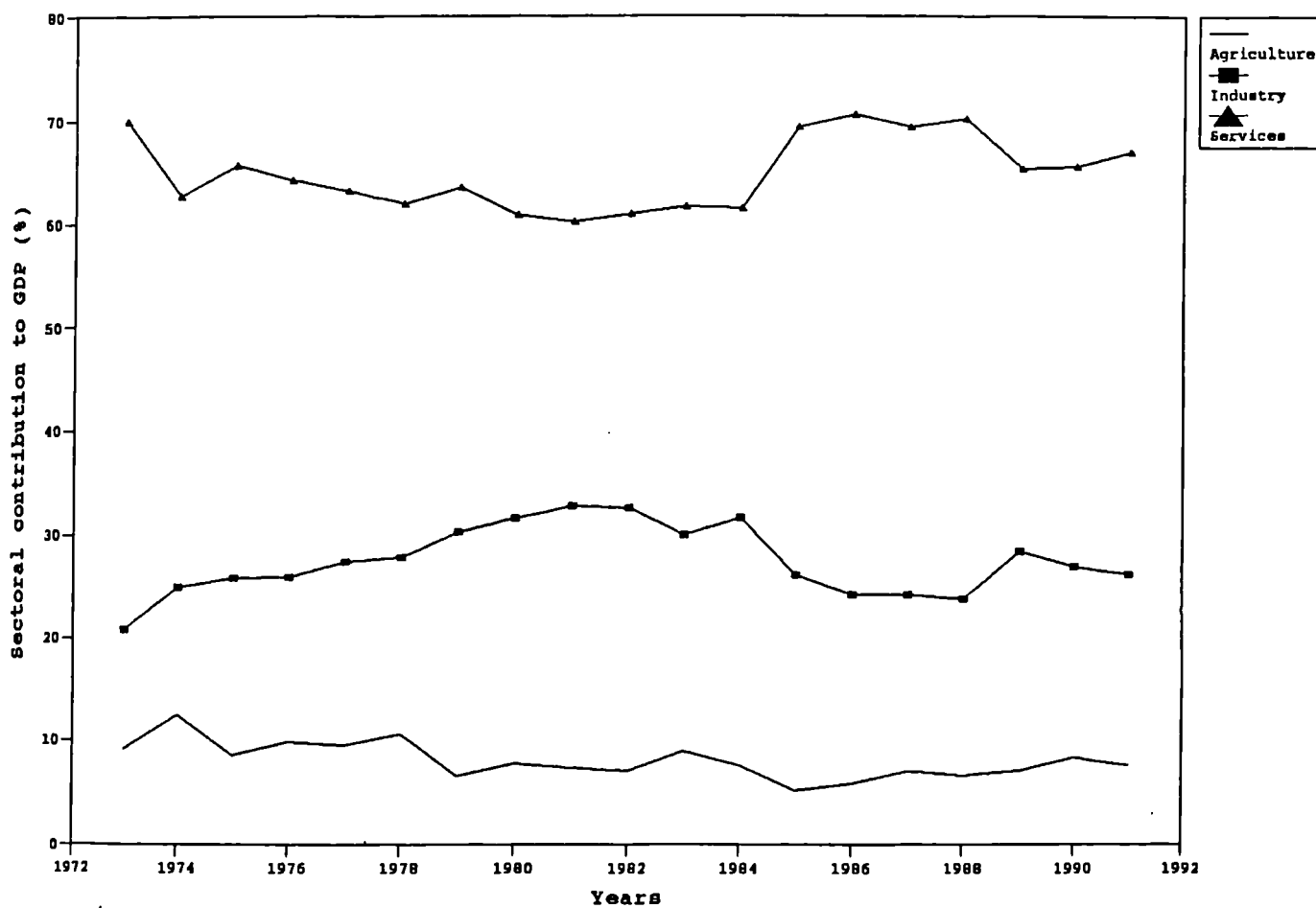
1973 and 1974 respectively, the relative importance of the agricultural sector dropped to around 7.5 percent in 1991 as figure (5.9) shows.

This decline, however, was accompanied by a sub-sectoral change in the production of the main crop groups as figure (5.10) asserts. While vegetables and field crops had been the main products of this sector during 1952-1972, this period experienced a major shift towards vegetables and fruit production. This caused the Kingdom to be highly dependent on food imports to meet the consumption demands of its population. In other words, the economy lost its "food security".

This shift from subsistence crops to cash crops manifested itself in a sharp decline in per capita field crops production during the period (1964-1991) as figure (5.11) illustrates. This can be postulated as the major reason behind the dependency conclusion which characterised the country's agriculture.

In 1956, the planted areas for wheat, barley, and chick-peas were (in thousand dunums) 2720, 1033 and 80 respectively (IBRD,1957). By 1991, however, they had declined to only 564.7, 655.2 and 14.8 thousand dunums (Department of Statistics, 1992), representing reductions of 80 percent, 37 percent and 82 percent respectively. Such a sub-sectoral deviation cannot be justified purely by market demand but should be seen on the one hand within the context of the domination of commercial farming and on the other within the increasing degree of monetization of

Figure (5.9): The Sectoral Contribution to GDP in Jordan
(1973-1991)

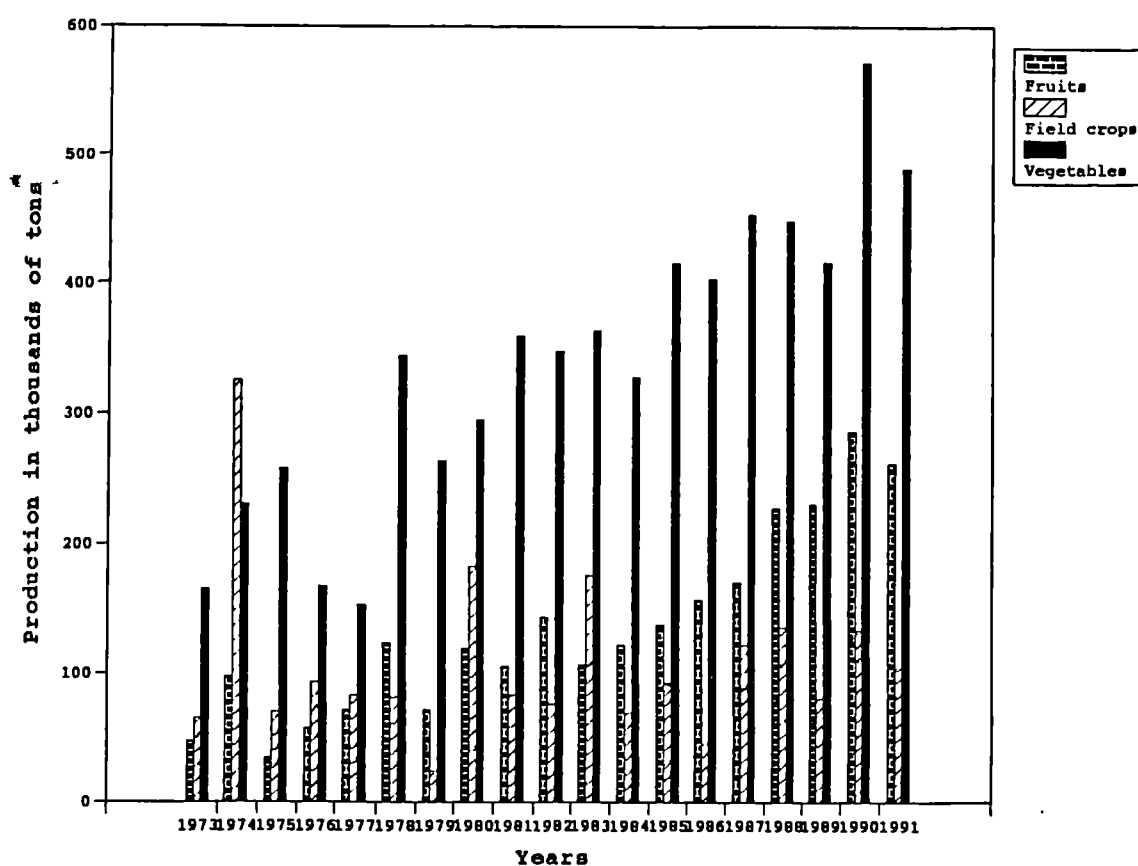


Sources:

Data are calculated by the researcher employing the data in the following sources;

- Central Bank of Jordan (1989, table no. 47, p.58)
- Department of Statistics (1992)
- Central Bank of Jordan (1992, table no. 46, p.80)

Figure (5.10): The Changes in the Production of Main Agricultural Crops Groups in Jordan (1973-1991)



Fruits (Olives, Grapes, Citrus Fruits, Bananas and Figs)
 Field crops (Wheat, Barley, Tobacco, Lentils and Vetch)
 Vegetables (Tomatoes, Eggplant, Cucumbers and Melons)

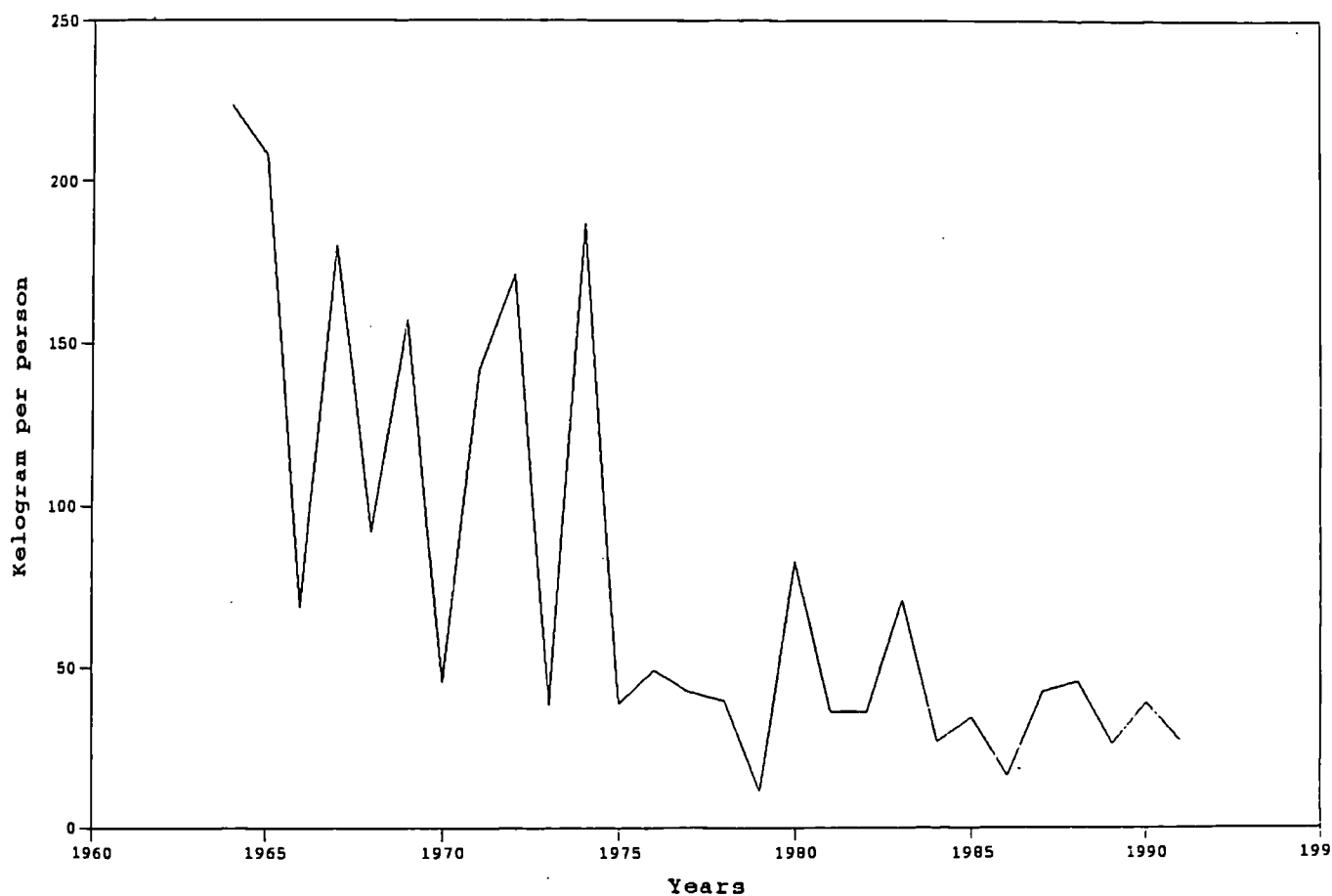
Sources:

Data are calculated by the researcher by employing the data in the following sources;

-Central Bank of Jordan (1989, table no.45, p.56)

-Department of Statistics (1992, table no 5/1/3, p.99)

Figure (5.11): The Changes in Per Capita Field Crops Production in Jordan (1964-1991)



*Field crops (Wheat, Barley, Tobacco, Lentils and Vetch)

Sources:

Data are calculated by the researcher employing the data in the following sources;

- Central Bank of Jordan (1989, table no.45, p.56).
- Department of Statistics (1992, table no. 5/1/3, p.99).
- Department of Statistics (1992, table no. 2/1, p.19).

the economy .

Nevertheless, it has to be asked why the decline in the overall agricultural contribution to the GDP was so rapid. Although it might be argued that such a decline reflects the structural change in the Jordanian economy, the size of the decline in the Jordanian agricultural sector is more than the average for developing countries. For example Kirkpatrick et al. (1984, p.13) showed that the agricultural contribution to GDP in the lower-middle income countries declined between 1960 and 1981 (by 38 percent) from an agricultural share of 36 to 22 percent. In the case of Jordan, however, the decline for the same period was by 50 percent, from about 16 to 8 percent. Thus, other factors might lie behind the rapid decline in Jordan.

The first reason could be explained by employing the institutional approach of Olson (1982). With the exception of a few capitalist farmers it has been merchants and middlemen who have generally dominated this sector. They supplied seasonal credit at high interest rates in order to reinforce the farmers state of indebtedness. In order to secure the repayment of their debt, merchants and middlemen operated as monopsonists in the field of marketing (Robins, 1986, p.84). That left the farmers in a weak position when negotiating the prices of their crops.

Thus, the collective action of merchants and middlemen against the unorganized and absent group of peasants led

to a devaluation of farming as a way of life in Jordan. As a result, between 1973 and 1990 the share of the labour force in the agricultural sector declined from 16 to 8 percent (Ministry of Labour, 1991). In comparison with lower middle-income economies distribution of labour force in the agricultural sector (55 percent in 1981), Jordan share seems to be very low (Kirkpatrick, et al., 1984, p.13).

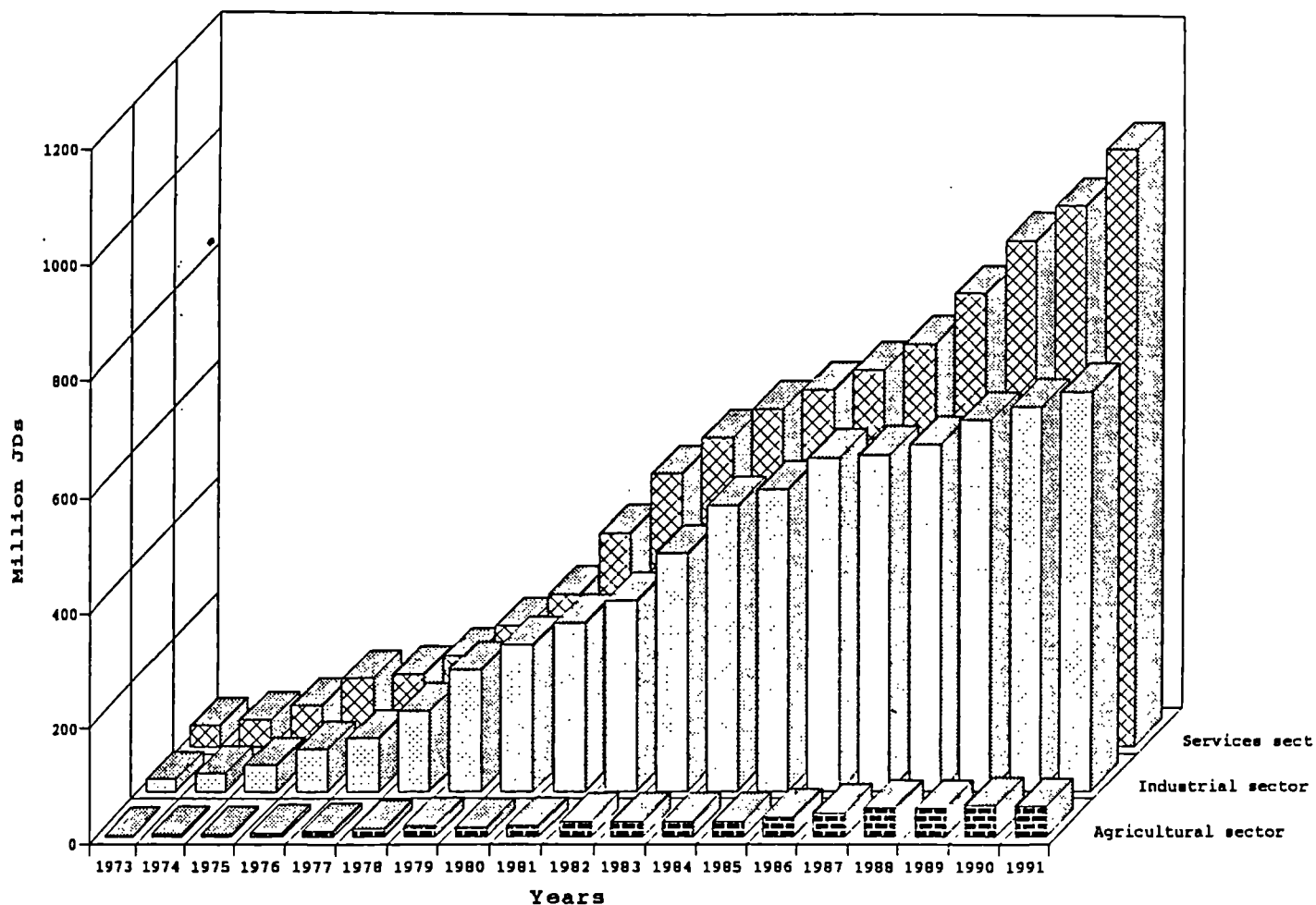
One of the main indicators for measuring the power of distributional interest groups in the economy is the sectoral distribution of commercial bank credits, all of which were in private ownership, between the three main economic sectors (agriculture, industry and services).

Figure (5.12) shows that the agricultural sector share of total credits was on average only about 3 percent during the period 1973-1991³ and never exceeded 5 percent.

It might be argued that there are other specialist financial institutions, such as the Agricultural Credit Corporation (ACC), which could lend to this sector. In practical terms, however, the ACC neither advances credit to cover the total cost of an agricultural project nor does it usually concern itself with the demands of small farmers. Its credits, as well as those from other commercial banks, are almost always channelled to capitalist farmers who can provide the required collateral.

³Calculated by employing the data available in Central Bank of Jordan (1989,1992).

Figure (5.12): The Sectoral Distribution of Private Sector Credits in Jordan (1973-1991).



Sources:

All data are calculated by the researcher employing the data in the following resources;

- Central Bank of Jordan (1989, table no.12, p.17).
- Department of Statistics (1992, table 17/10, p.406).

The effect of merchants and capitalist farmers as special interest groups has been contributing to the decline of agricultural production on the one hand and to crowd-out small farmers on the other.

Another interpretation of the sub-sectoral shift in production could stem from Ahmed and Ruttan's (1988) concept of "institutional biases"

They argue that there are institutional biases which lead to the decline of agricultural production in LDCs.

In the case of Jordan, research and extension programmes (i.e., Jordan Valley) are biased in favour of traded (in particular, export crops such as vegetables and fruits) as opposed to subsistence crops. The latter which are produced by the resource-poor peasantry are neglected because the growers are unable to voice their demands for appropriate infrastructure (i.e., irrigation schemes) and appropriate technology (i.e., seeds and water pumps for underground irrigation).

As only 7.6 percent of the cultivatable land areas, which total about 528,300 ha, is irrigated land located in the Jordan Valley, farmers and particularly the poor are heavily dependent on rain which fluctuates in volume from one year to the next.

Another institutional bias is that the priorities in national planning programmes are influenced by the

strengths of different interest groups; on a macro-level urban bias can be cited as clear evidence of this. Ahmed and Ruttan (ibid, p.12) claim that there is a negative correlation between urbanization and the level of agricultural research and extension expenditure. In the case of Jordan, urban bias has led to a sizeable demand for wheat aid from the United States instead of a search for other policies which could increase wheat production in Jordan. Consequently, prices of wheat have declined and become unprofitable crops for small farmers to produce.

One of the main attributes in Jordan is government interventionist policies which have been characterised by poor management and poor coordination among its different agencies.

Another factor is the uncontrolled urban expansion at the expense of agricultural land caused by extensive migration from rural areas to the cities. This resulted from the uneven distribution of services and the large numbers of educated people seeking employment opportunities in the cities (Abu-Zant, 1988).

On the demand side, the reason for decline in the agricultural contribution is the loss of some traditional markets due on the one hand to the reduction in quality and high production costs and on the other the new agricultural policies in neighbouring countries which constitute the traditional regional markets for Jordan.

However, regional political spillover also has a major role to play in the demand for Jordanian agricultural production. For example, during the Gulf War of 1990/1991, the markets of the Gulf States were closed to the Jordanian crops. This led to heavy losses for Jordanian farmers. The exports of the agricultural products constituted 11 percent of all exports of goods in Jordan during 1990 and 1991 while the percentage of imported agricultural products to that of exports was more than 400 percent and more than 100 percent of the value added of this sector in 1990 and 1991 (Ministry of Planning, 1994, p.45).

In order to assess the contribution differences of the agricultural sector to the GDP growth in Jordan with those of East Asian countries, a comparison with South Korea reveals the following;

While both countries have experienced a decline in the agricultural sector contribution (table 5.4 and 5.5), the difference between the two is that South Korea witnessed an industrial revolution and a structural change in the economy through the adoption of dynamic export policies based on an effective land reform programme in 1948-1950 (Wade, 1990) (Koo and Kim, 1992). Land was redistributed to establish a basis for individual peasant agriculture, which was not the case with the land settlement program in Jordan during 1957. This left lands to speculators in the market rather than to farmers. Thus, although the

Table 5.4

The Relative Structural Importance and Contribution
of the Economic Sectors to the GDP in Jordan
(1973-1990).

Detail ---- Years	Agriculture (%) [1]	Contribution to growth (PP) [2]	Industry (%) [3]	Contribution to growth (PP) [4]	Services (%) [5]	Contribution to growth (PP) [6]
1973	9.3	-3.1	20.8	6.7	69.9	32.3
1975	8.6	-1.2	25.8	16.2	65.6	20.3
1980	7.8	4.6	31.5	12.3	60.7	17.1
1985	5.1	0.7	25.8	-3.2	69.1	5.5
1986	5.7	0.2	24.0	1.3	70.3	10.8
1987	6.9	1.6	24.0	0.3	69.1	1.9
1988	6.5	1.6	23.6	-1.7	69.9	0.1
1989	6.9	-1.3	28.1	2.9	65.0	-9.3
1990	7.5	1.2	25.9	-0.4	66.6	0.4

Sources:

1. Data for 1973-1980 ; World Bank (1987).

2. Data for 1985-1989 ; World Bank (1992).

-(PP) Percentage Points are calculated by the World Bank (1985-1990) and by the researcher (1973, 1975 & 1980).

Note:

The industrial sectors implies; mining and quarrying, manufacturing, electricity&water supply, and construction.

The services,etc sectors implies; trade,restaurants & hotels, transport & communications, finance & other services, and government services.

Table 5.5

The Relative Structural Importance and Contribution
of the Economic Sectors to the GDP in South Korea
(1966-1990)

Detail ----- Year	Agriculture (%) [1]	Contribution to growth (PP) [2]	Industry (%) [3]	Contribution to growth (PP) [4]	Services (%) [5]	Contribution to growth (PP) [6]
1966	34.9	n.a.	25.6	n.a.	39.5	n.a.
1970	26.0	n.a.	29.2	n.a.	44.8	n.a.
1980	14.6	n.a.	41.3	n.a.	44.1	n.a.
1985	13.4	0.5	41.0	2.8	45.6	3.6
1986	12.3	0.6	42.4	6.5	45.3	5.2
1988	10.3	0.9	43.6	5.1	46.1	5.2
1989	9.5*	-0.2	43.7*	2.9	46.8*	3.7
1990	n.a.	-0.1	n.a.	5.2	n.a.	4.2

Sources:-

1.Data for 1966-1985 ; World Bank (1987).

2.Data for 1986-1990 ; World Bank (1991).

Note: The sectoral contribution to GDP growth combines information about growth rates and percentage shares of GDP components. It is measured by "percentage point of GDP" (PP). This form shows, by how much GDP would have changed if other GDP components were unchanged.

(*) estimated.

structural change in the agricultural sector of South Korea seems to be similar to Jordan, but the shift in Jordan led the economy to be more services rather than industrial oriented. This can be shown by the wide differences between the two in the industrial sector contribution to growth. In South Korea was on average about 4.4 percentage point during 1988-1990 while in Jordan was -0.7 percentage point for the same period.

5.4.1.2: The Industrial Sector

In the industrial sector (mining and quarrying; manufacturing; construction; electricity, gas and water) there was an increasing share of contribution to the GDP, from 20.8 percent in 1973 to 25.9 percent in 1991 (figure 5.9 and table 5.4).

This trend was an analogue of Jordanian government industrialization policies started in the early 1970s, particularly during the period 1976-1980. During this period a sizeable amount of foreign transfers was received from the Arab countries and Gulf oil states in particular, after the 1970s' boom in the price of oil.

Government industrialization policies were a continuation of those followed in the first phase. The emphasis was mainly on RBI. The intention was to promote the export of mineral resources (phosphate and potash). In other words, industrialization policies were a mixture of RBI and export-promotion. However, the investment in projects such as cement works, an oil refinery, chemicals, batteries and

glass factories were a demonstration of ISI.

In the manufacturing sub-sector, small scale factories have dominated industry with its mixed goals of import-substitution and export-promotion. Particularly after 1980 this latter was motivated by a sudden increase in the demand for Jordanian products from Iraq following the start of the Iranian -Iraqi War in 1980. On average this sub-sector contribution to the total industrial output was about 43 percent during the period 1986-1992 (Ministry of Planning, 1994, table no.4, p.8). Despite that, the relative importance of manufacturing imported products to that of exports was more than 400 percent during 1987-1991 (ibid, p.46).

The question is: what are the main problems of the industrial sector in general and that of the manufacturing sub-sector in particular?

The first problem is the narrowness of the domestic market. Jordan is a small country with a limited market, thus the policy of import-substitution industrialization pursued throughout the 1970s was not an appropriate alternative to industrialization and growth. Such an assessment is supported by Chenery, Robinson and Syrquin (1986). Nevertheless, when started in the 1950s and 1960s, ISI was a necessity rather than an option. Since 1970, however, ISI has become an option chosen by the decision makers in order to build a modern industrial base for the

economy. This consequently initiated what Page (1990) called an **extensive growth** in the industrial sector. This extensive growth was based on **factor accumulation** rather than on productivity. What is needed is more intensive growth which relies on a balance between factor accumulation and factor productivity.

The second problem is related to the size of the firms. In countries such as Jordan where small firms or the informal sector denote the bulk of the industrial sector (80.2 percent of the total number of industrial firms employed fewer than five employees) (Department of Statistics, Industrial Census, 1984), industrial policies have to differ from those adopted in developed countries.

Although Jordan has always been a country with a liberal economic policy, free-market policies are not equal in their effects on different countries.

How could the effect have been equal when total Jordanian industrial output, for example in 1986, amounted to only one percent of that of G-M in the United States (i.e., \$1.21 bn in Jordan while \$102.8 bn for G-M) and only 2 percent of IBM output.

According to the Jordanian Industrial Census of 1984, the number of industrial establishments employing more than five employees was 1686. These employed a total of 41.8 thousand workers (25 workers per establishment). Their capital/value added ratio was 4.1 which is high and

reflects the capital intensity characteristic of these new enterprises. This is because such enterprises were mainly in mining and quarrying, petroleum refining, non-metallic mineral products and chemical products which required more capital intensity than the one dominated the informal sector.

On the other hand, the number of establishments with fewer than 5 workers was 6847 with an average of 2 workers each. Their capital/value added ratio is only 0.5 which reflects their simple technological base as well as their contestability as they do not require huge sunk costs (costs of entry and exit).

Thus, the differences in internalizing many of the mechanisms and externalities, such as the flow of information and the coordination of investment decisions as Stiglitz (1989) contended should be recognized when free market advocates defend the success of the market ideology in the West.

Such an explanation is supported by Krugman (1993) when he argues that

"the counterrevolution went too far, by neglecting the central idea of the high-development theory which are external economies and strategic complementarity" (Krugman, 1993, p.16).

Western corporations such as G-M, IBM or those in East Asia such as Nissan, Hyundai surpass the largest enterprises in the Jordanian economy. Firms such as Jordan Phosphate Mines (4197 workers), Jordan Petroleum Refinery

(2787 workers) and the Arab Potash Co. (1320 workers), cannot be compared with enterprises employing hundreds of thousands of workers as is the case in the developed World and the NICs.

Market structure and competitiveness are a constraint on the Jordanian industrial sector.

For example Lee (1992) argues that one of the factors which contributed to the development and success of South Korea was the government-business relationship. This constituted an internal organization or quasi-internal organization which internalized many of the externalities found in the market place. However, such relationship is not the case in Jordan. Rather, because informal industries are constituting the bulk of the manufacturing sector, they tend to operate on the fringe of the law and have no channels to voice their demands' for the government.

Another important problem is the lack of linkages or complementarities within the economy.

Hirschman claims that forward and backward linkages are a necessity in order for an economy to perform effectively. ISI has had a negative effect on the interconnection between the different sectors comprising the Jordanian economy, particularly within the industrial sector.

Most of the firms have relied on imported raw materials as inputs for their products. Thus, the complementarities between the industrial sector in general (especially the

manufacturing sub-sector) and the agricultural sector have been weak. For example the private industrial sector (constituting more than 85 percent of the sector) is mainly concentrated in textiles, clothing, pharmaceutical products, food stuffs, soaps and detergents, almost all of which are dependent on imported inputs.

Thus, although the share of the industrial sector increased between 1970 and 1991, its contribution to the growth of the Jordanian GDP in comparison with that of South Korea was limited, particularly after 1985.

The question is, therefore, why was industrialization a story of success in South Korea or in East Asian countries in general and a failure in Jordan?

Sachs explained the causes of success and failure of industrialization, growth and development when he compared the successful economic experience of South East Asian countries (i.e. dynamic export-oriented industrialization) with its opposite side of Latin America (i.e. ISI). He found that the crucial variable which explained the differences between the two regions lies in the differences between the breadth of ownership and land distribution in the two regions [Sachs (1989) as cited in JR. James (1992, P.247)].

For example in South Korea and Taiwan, there was a broad land distribution which created a large interest group of rural exporters who opposed an overvalued exchange rate. In contrast with the uneven distribution of rural land in Latin America, devaluation was resisted by the majority of

the population because it would have worsened the distribution of income by channelling it from the mass population towards a small class of landlords and exporters. Thus, South Korea and Taiwan followed the path of export-oriented policies without resistance, while Latin American states implemented an ISI due to the resistance of the majority of the population. The result was failure in the latter and success in the countries of East Asia.

Within the Jordanian context this could provide a valid explanation for the story of failure. As mentioned earlier in the chapter, the land settlement programme in Jordan introduced in 1957 was not a land reform programme with economic objectives as was the case in East Asia but a registration of the existing traditional rights. As a result the distribution of land in Jordan worsened, and with it income and wealth because land in the rural areas was left to the speculators in the urban areas to trade in.

Another contributor to the industrial sector expansion in Jordan is the augmentation of the construction sub-sector. On average it contributed about 40 percent to the total output of the industrial sector during 1973-1985. (Central Bank of Jordan, 1989, table no.27, p.58) Government investments in infrastructural activities contributed significantly to the flourishing of this sub-sector. However, both government investments in infrastructure and

private construction activities, mainly housing, were linked to external sources of finance (grants and workers' remittances), which led to a reduction in the contribution of this sector (total industrial sector) to GDP growth after 1985. On average during 1986-1992 the contribution of this sub-sector to the total industrial output declined to only 30 percent (Ministry of Planning, 1994, table no. 4, p.8). As we shall see in the subsequent sections of this chapter this was due to the decline in the volume of external finance.

5.4.1.3: The Services Sector

On average, more than 60 percent of the country's GDP was generated from this sector during the period 1973-1991 as shown by figure (5.9).

Such a relatively large share for this sector, which is comprised of government services, the wholesale and retail trade, transportation and business services, has often been a feature of the changing economic structure in developing countries. In the case of Jordan, the private services sector illustrates the traditional strength of the merchant business culture.

According to Mancur Olson (1965, 1982), growth is hindered in countries monopolized by special interest groups. In countries where such groups have been nullified in the course of war or revolution, prosperity and growth tend to be quite rapid once a free and stable legal framework is established. Olson's examples were Germany

and Japan after 1945. In the case of Jordan, the traditional special interest group is that of the merchants (importers and traders in general as well as bankers). This interest group has often influenced government policies and decision making through maintaining overvalued exchange rates, affecting the allocation of credit, as figure (5.12) shows, as well as other tariff rates and protectionist policies. Thus, and as table (5.4) stresses, the contribution of the services sector to GDP growth was significant in comparison with the other two sectors. But, this factor does not explain all the reasons behind the increasing domination of this sector.

During this period there were other factors which affected the expansion of this sector in addition to the powerful private business class. The first was the Lebanese civil war which started in 1976. Before this time it had been believed that Amman would be an appropriate alternative to Beirut as the main business centre in the Middle Eastern region. For this reason the government established a financial market [Amman Financial Market (A.F.M)] and started to encourage Jordanian as well as Arab companies to participate in its activities although Amman was not expected to become an international financial centre like the United Arab Emirates (U.A.E.). Many foreign banks found Amman a useful location for the remaining businesses in Lebanon as well as for trade finance for Iraq, which

does not permit foreign banks to operate within its borders. The number of commercial banks and branches rose, during this period (1976-1991), from 88 to 330 (Central Bank of Jordan, 1992, pp. 4-5). This is a reflection of an increasing trend towards monetization of the economy and a resulting increase in the contribution of the services sector to the country's GDP.

The second reason was the Iran-Iraq War which started in the last quarter of 1980. Jordan through its port of Aqaba was the main gateway for Iraqi imports (transit trade), a factor which encouraged Jordan to mobilize sufficient resources to establish new service institutions and transportation services to fulfil the new demands. The government undertook major investment in telecommunication and transportation projects in order to induce more foreign companies to locate in Jordan.

Both of these factors as well as the decline in the share of the agricultural sector have contributed to the characterization of the Jordanian economy as a services oriented economy.

Furthermore, the relatively stable regional politics and relations between Jordan and the other states in the region during 1973-1988 resulted in increasing regional tourism. The latter became an additional source of revenue for this sector and investment in tourism became profitable for the private as well as the state sector.

After 1988, however, two non-economic factors have led to a decline in tourist revenue. The first was the decision by Jordan to cut links with the West Bank and the second and [the] most important was the Gulf war (1990/1991). While income from tourism increased from 186 MJDs in 1986 to 339 MJDs in 1990, it declined to 216 MJDs in 1991 (Ministry of Planning, 1994, p.48).

In general, however, services continued to dominate the orientation of economic activities in the Kingdom with the sector absorbing on average 68 percent of the total work force.

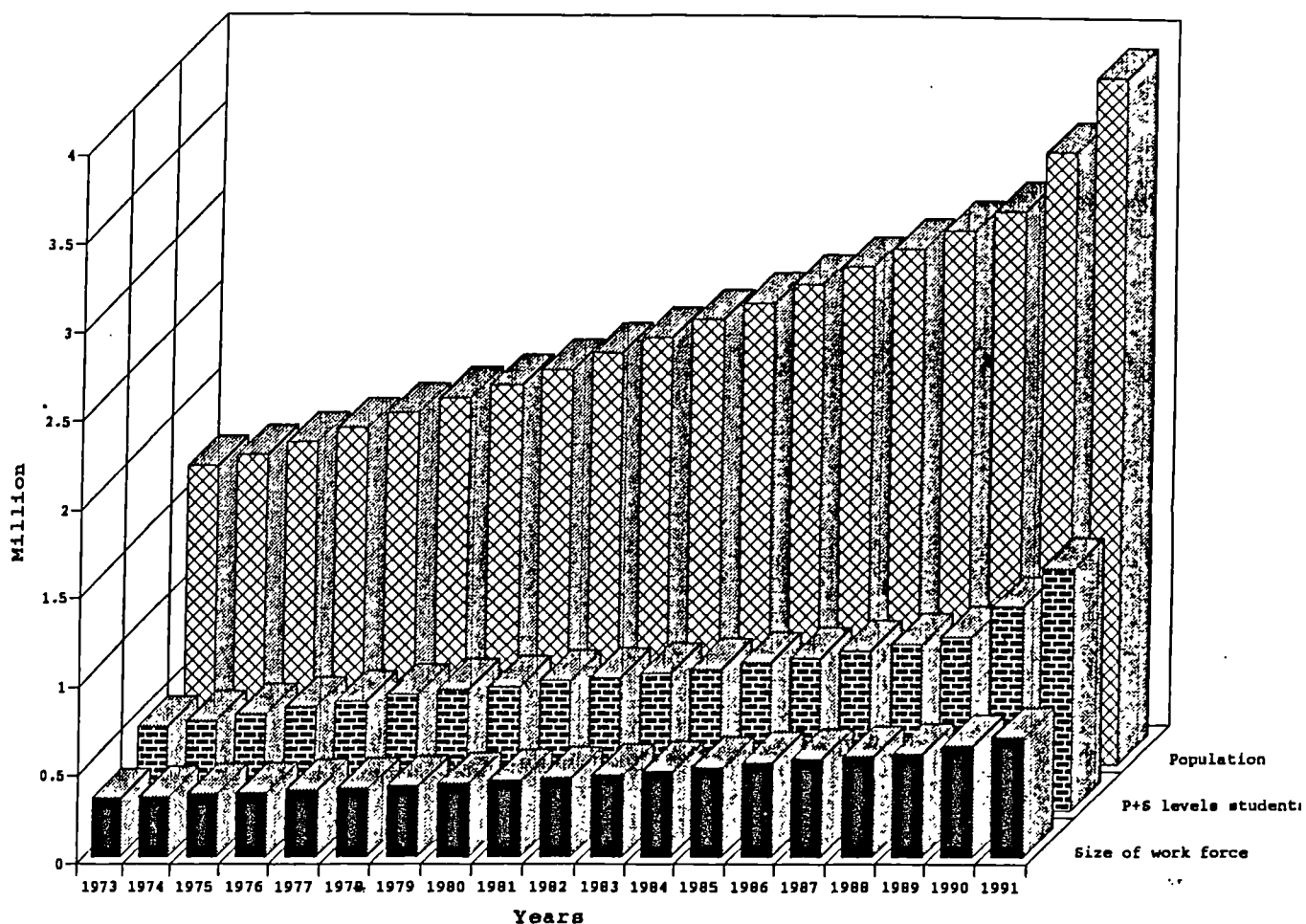
5.4.2: The Demographic Constraint

The population of Jordan is characterised by a high annual growth rate. During the years 1973-1989 the population increased by 4 percent annually as figure (5.13) shows. About 3.5 percent was due to natural increase while 0.5 percent was the result of net migration in particular by foreign workers.

However, the participation rate did not change during this period in comparison with 1952-1972; on average it was about 20 percent. It did not decline until 1990-1991 with the sudden increase in population caused by the flow of some 300 thousand returnees from Kuwait and other Gulf states after the Gulf crisis.

In comparison with the East Asian countries Jordan's participation rate seems to be too low. For example, in South Korea and Hong Kong the rates were 43.4 percent and

Figure (5.13): The Size of Population, Schooling and Employment in Jordan (1973-1991).



Sources:

- Population data from Department of Statistics (1992, table no. 2/1, p.19)
- Workforce data from Ministry of Labour (several issues)
- Number of students data from Ministry of Education (several issues) and Department of Statistics (1992, table no. 3/1/10, p.244) and *ibid* (table no. 10/2/16, p.260).

49.5 percent respectively in 1990; in Malaysia, the participation rate was 43.8 percent in 1987; and in Singapore, about 48.6 percent of the population participated in the economic activity in 1989 (ILO, 1991). Thus, Jordan's low participation rate implies a high number of dependants per labourer. Such low participation rate is the result of four major factors; The first and the most important is that more than half of the Jordanian population is under the age of fifteen, while in South Korea the figure is only 28.3 percent, in Hong Kong 21.5 percent and in Singapore 23 percent (ILO, 1991). Secondly the Jordanian female participation rate is rather low (although increasing) being only 10.1 percent in 1989 (Ministry of Labour, 1990). The assessment that this rate is further justified when compared with that of South Korea (33.9 percent) in 1989 and Singapore (32.4 percent) in 1988 (World Bank, 1991).

Another reason for the low participation rate in the labour force is that large number of workers migrate to the Gulf states, and their numbers were significant till the mid-1980s when Jordan experienced a shortage in its domestic labour force and simultaneously became an exporter and importer of labour.

The last factor is, the high rate of participation in schooling. Jordanians normally enter the workforce on completion of compulsory education about the age of fifteen. However, there is still a high number who attend high school and post-high schools. In 1990, approximately

one-half of the population attended such schools (Dwairi, 1991, p.220). Meanwhile, the rate in the primary and secondary school was about 35 percent in 1991 as figure (5.13) illustrates.

In comparison, the rate of primary and high school attendance in South Korea was 20.8 percent in 1988 and that of Singapore was 17.4 percent for the same year (Unesco, 1990).

Moreover, the structure of the workforce in Jordan experienced a shift from the agricultural sector towards the industrial and services sector. While in 1973 the agricultural workforce constituted 16.3 percent, it declined to only 7.8 percent in 1990. Within the same period there was an increase in the industrial sector from 19.5 to 23.4 percent and in the services sector from 65.1 to 68.8 percent (Ibrahim, et al., 1990, p.60) (Ministry of Labour, 1991).

The change in the structure of the workforce mirrored the parallel change which had occurred in the sectoral contribution to the GDP.

5.4.3: High Degree of Economic Openness

The period 1973-1991 experienced a higher degree of economic openness than the period 1952-1972. The ratio of economic openness was 52.7 percent in 1973 rose to about 96 percent in 1991 as table (5.6) shows. This high ratio reflects a high dependency on imports rather than

successful achievements on the side of exports. As the volume of external transfers (grants and workers' remittances) increased, the country's propensity for imports increased as well. The increase in imports was important as a way of meeting the growing demand for capital and intermediate goods and raw materials, particularly during the 1970s and early 1980s.

Table 5.6

Economic Openness Ratios and the Size of Trade Deficit in Jordan (1973-1991)

Years	Imports MJDs [1]	Exports MJDs [2]	GNP MJDs [3]	Openness ratios (%) [4]	Trade deficit MJDs [5]	GDP MJDs [6]	Outward orientation (%) [7]
1973	108.2	19.0	241.5	52.7	-89.2	218.3	8.7
1975	234.0	48.9	376.0	75.2	-185.1	312.1	15.6
1977	454.5	82.1	660.1	81.3	-372.4	514.2	15.9
1979	585.6	120.9	972.9	72.6	-464.7	976.6	12.4
1981	1047.5	242.6	1484.2	86.9	-804.9	1426.7	17.0
1983	1103.	210.6	1815.0	72.4	-892.7	1765.8	11.9
1985	31074.4	310.9	1935.8	71.6	-763.5	1940.6	16.0
1987	915.5	315.7	2086.1	59.1	-599.8	2136.2	14.8
1989	1230.1	633.0	2280.2	81.7	-597.1	2043.2	31.0
1991	1710.5	770.4	2586.3	95.9	-940.1	2805.5	27.5

Sources:

-Imports and exports data from Department of Statistics (1992, table no. 19/1/1, p.434).

-GNP and GDP data from Central Bank of Jordan (1989, table no. 47, p.58) and Central Bank of Jordan (1992, table no.46, p.80).

-Openness ratios $[(Imports+Exports)/GNP]$, trade deficit, and outward orientation ratios $(Exports/GDP)$ are calculated by the researcher.

This was accompanied by a demand for imported food stuffs and consumer goods as per capita income increased.

Jordanian imports during the period 1973-1980 grew at an annual rate of 26.6 percent, from 108.2 MJDs in 1973 to

716 MJDS in 1980, and in 1981 alone the rate increased by as much as 46 percent. There were two main reasons. The first was the mounting cost of imported oil because of its price rise. The second reason was the increasing demand for Jordanian manufactured products from Iraq after the start of the war with Iran in 1980. As the manufacturing base in Jordan is linked (inputs requirement) with the outside world (weak linkages effect), an increase in the imports requirement was to be expected. Both factors were supported by an overvalued exchange rate which encouraged the increasing trend towards imports⁴.

Nevertheless, this upwards trend continued during 1982-1989, but much more slowly (only 4.1 percent annually). This was mainly due to the decline in oil prices, the sharp drop in Iraqi imports from Jordan after 1982, the overall recession since 1983 and the devaluations of the Jordanian dinar in October 1988 and August 1989. However, the Gulf crisis in 1990/1991 played a major role in increasing the imports burden on Jordan. The volume of imports increased by 40.3 percent in 1990 (IMF, 1993) when Saudi Arabia decided to cut its oil exports to Jordan through the Tapline (Independent, 1990,P.10), and Iraq was lost as a major supplier of oil to the Kingdom. Both these factors meant that Jordan had to pay more for its imported oil from countries such as Syria and Yemen.

This shows that economic and non-economic factors were

⁴Until 1988, the exchange rate of Jordanian dinar was 1JD = \$3.0.

behind the Kingdom's fluctuating bill of imports. This high dependency on regional factors has increased the pressure on the Jordanian government to formulate crisis driven policies rather than a clear strategy for controlling imports.

Exports on the other hand increased from 19 MJDs in 1973 to 49.8 MJDs in 1974. This increase was mainly attributed to a rise in the unit price of exports and a relative increase in unit volume, mainly in food and live animals, raw materials (phosphates and potash), and manufactured goods (Central Bank of Jordan, 1989, table 30).

During 1974-1979 Jordanian exports grew at an annual rate of 19.4 percent, from 49.8 MJDs in 1974 to 120.9 MJDs in 1979. This significant increase was due to rises in the production and export of phosphates and potash as well as increases in demand for Jordanian products from the regional markets.

The regional effect played a significant role during 1980-1982. Iraq started to supply its domestic market with Jordanian products as its requirements increased after the Iran-Iraq war in September 1980.

In addition, rises in the prices of phosphates contributed significantly to total export earnings.

During the three years (1980-1982), Jordanian exports had more than doubled, from 120.9 MJDs in 1979 to 264 MJDs in 1982 but, as Iraq decided to reduce its imports in 1983 and the prices of phosphates dropped on the World markets

(by 17 percent of the price index of 1980) (IMF,1992), the total value of Jordanian exports declined by 25 percent in 1984.

As the production capacity of phosphate and potash increased during 1984-1991, Jordanian exports started to increase from 290.7 MJDS in 1984 to 770.7 MJDS in 1991. This remarkable increase was mainly due to two factors. The first reason was the increases in the price of phosphate by 200 percent in 1990 and 1991, in comparison with 1985 (IMF,1993). The second reason was the devaluations of the dinar in 1988 and 1989 which increased total domestic currency earnings. However, the efforts of Jordanian governments to promote exports must not be underestimated. Since 1985, export promotion policies in the field of mineral production have born fruit. The export/GDP ratio or the degree of outward orientation increased from 15 percent during the second half of the 1970s to about 27 percent in 1991.

However, the dependency on regional markets is the main weakness for Jordanian exports. The impact of the Gulf crisis has reduced the country's manufactured exports. The international embargo on Iraq as well as unstable political relations with the Gulf states have deprived Jordan of its traditional markets in those countries.

This can explain why export-promotion policies in Jordan are dependent not on domestic policies per se, but also on regional politics and the prices of its most valuable minerals on the world markets.

This unbalanced exports-imports trends increased the economy's trade deficit tenfold during the period 1973-1991. It rose from little -89.2 MJDs in 1973 to -940.1 MJDs in 1991. In 1992, however, the trade deficit figure exceeds the one billion JDs mark as it stood at 1158 MJDs (Ministry of Planning, 1994, p.24).

5.4.4: Semi-Rentier Economy

The Jordanian economy had always had the features of a semi-rentier economy. During this second phase of its current history, there was more than one factor to justified its assessment as a semi-rentier economy.

However, before presenting the different factors, it is wise to clarify the concept and meaning of a rentier economy in this instance.

There are three main characteristics of a rentier economy⁵; firstly, foreign revenue play a dominant role, particularly in the composition of government revenue; secondly, the size and the flow of such foreign revenue are not related to the productive capacity of the economy; thirdly, the foreign revenue depends on decisions and factors over which the recipient has either little or no control.

Such characteristics of rentier states are apparent in the majority of OPEC (Organization of Petroleum Exporting Countries) countries, particularly those in the Middle East, often dependent on crude oil exports as the main

⁵for an over review of the concept see Beblawi (1990).

source of foreign revenue. During the oil boom of the 1970s and early 1980s, crude oil exports constituted more than 90 percent of total export earnings in the oil rich Gulf states.

Consequently, government budgets in those countries relied on financial resources generated from oil exports. These resources are not in the main derived from components of the oil industry, but rather from external economic rents which derive from the wide gap between the low cost of producing crude oil and its relatively high price on the world's markets.

The size and flow of these rents are almost wholly dependent on the international market price of oil, that individual oil producer countries can not control and collectively (through OPEC) have practically weak control⁶.

The question is, what is the relationship between the oil rentier economies, particularly in the Arab Gulf states and the Jordanian economy?

There are two important connections between Jordan and those economies, firstly grants and secondly remittances transferred by Jordanians working in the Gulf states.

5.4.4.1: Arab Grants

Although Jordan is not an oil-producing country, its

⁶ For full discussion to the role of OPEC in determining oil prices, see Spero (1993, pp.261-301).

economic take off was linked to the oil economies of the region. When oil revenues rose dramatically between 1973 and 1980, grants from Arab oil countries ensured a flow of windfall revenues, producing the boom years of the Jordanian economy (the 1970s and early 1980s).

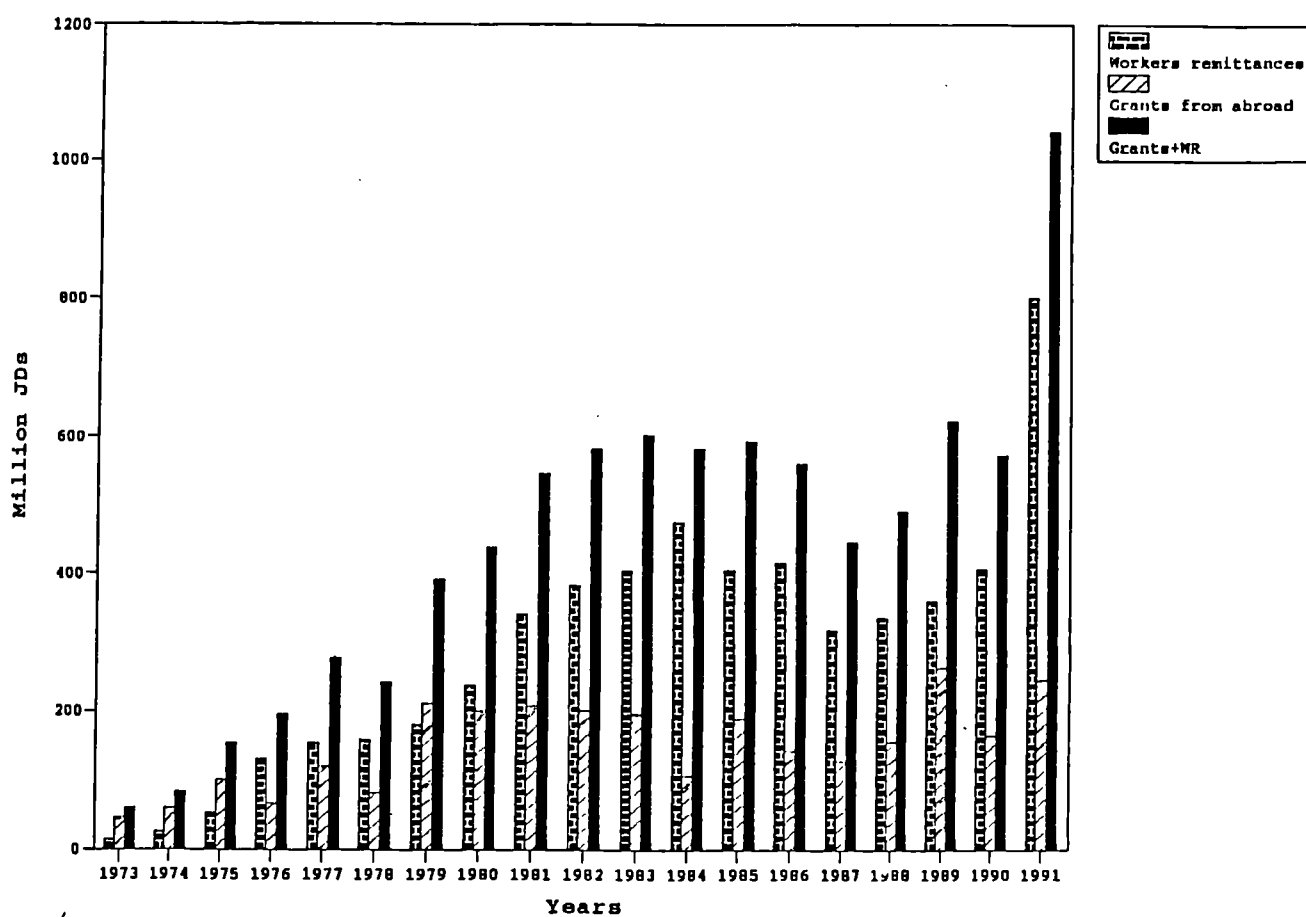
As figure (5.14) shows, the amount of grants received increased from about 46 MJDs in 1973 to 122 MJDs in 1977. However, 1978 denotes the turning point in the volume of grants transferred to Jordan. After the unilateral Egyptian peace negotiations with Israel, the Arab Summit in Baghdad decided to make annual transfers of \$1.25 bn to Jordan for a period of 10 years on the ground that it was a front line state. The size of the transfers actually never achieved the above figure but, was backed [during the 1970s] by a flood of petrodollars from the oil economies of the region.

In 1979 alone, Jordan received about \$700.3 mn in the form of cash grants, mainly from the oil rich Arab states.

Another important feature of these grants is that they were cash grants which differentiate them from other kinds of aid sent to Jordan (i.e. development assistance aid). While the former are left to be utilized (freely) by the Jordanian government, the use of the latter is conditional on the implementation of certain development projects. Thus, the allocation decisions relating to cash grants were left to the Jordanian decision makers.

During 1978-1983, the annual average of grants received by

Figure (5.14): Grants and Workers' Remittances Trends in Jordan (1973-1991).



Sources:

- Central Bank of Jordan (1989, table no.38, p.46)
- (*ibid*, table no.21, pp.26-29)
- Central Bank of Jordan (1992, table no.1, pp.6-7)
- IMF (1992, p.318).

Jordan was about \$600 mn.

It appears that Jordan was linked to the oil circulation of the rentier economies of the region. Thus, while rises in oil prices contributed positively, declines had a negative effect.

The sharp drop in oil prices after 1983 resulted in a substantial decline in these grants. Their volume dropped in 1984 by half compared with 1983. In addition, since 1985, the share of Arab grants as a percentage of the total grants received by Jordan declined from 90 percent in 1985 to only about 60 percent in 1990 (EIU, 1993, p.34). This was due a mixture factors of economic recession in the oil rentier states, the end of the transfers period, and geopolitical factors⁷.

This explains why Jordan was not in control of such revenue. One manifestation of the uncertainty characteristic of grants is the decision at the last Baghdad Summit (May 1990) to transfer \$200 mn to Jordan in the second half of 1990. This failed to materialise after the start of the Gulf crisis in August 1990 (Ibid).

In summary, while grants were important as a source of foreign transfers, they led to dependency surrounded by uncertainty. The links with the rentier economies of the region on the one hand, and the "no control" character on the other left Jordan vulnerable to exogenous economic and non-economic variables in a region the main character of

⁷The Jordanian decision of cutting the links with the West Bank in July 1988 and the start of the Gulf crisis in August 1990.

which has been instability.

5.4.4.2: Workers' Remittances

The second main source of Jordan's links with the rentier economies of the region is workers' remittances as figure (5.14) depicts.

The growth in remittances was due to two factors. The first, an increase in the number of Jordanians working abroad, from 150 thousand workers in 1973 to about double this number in 1979 and to 329 thousand workers in 1987 (Ibrahem, et al., 1989). Meanwhile this factor was accompanied by a rise in the wages and salaries of workers in the Gulf states arising from oil windfall revenues (1970s and early 1980s). As a result of both these factors, remittances rose from 14.7 MJDs in 1973, to 236.7 MJDs and 475 MJDs in 1980 and 1984 respectively.

However, both these previous factors, in the same way as grants, are determined by the economic conditions of the rentier economies of the Gulf states.

Another group of variables are non-economic. The political relationship between Jordanian governments and the PLO is very important, because the majority of Jordanians working abroad are of Palestinian origin (about 90 percent). [Until July 1988] the relationship could be described as relatively stable. On the other hand, the political relationship between Jordan and the Gulf states is also a significant factor in determining the size of remittances flow.

On the economic side, as recession hit the oil rentier economies of the region after the mid-1980s, the size of remittances declined from its peak in 1984 (475 MJDs) to 317.7 MJDs in 1987. Wages and salaries had been reduced. In addition the demand in the Gulf states for skilled Jordanian labourers swung towards the cheaper, unskilled workers of East and South East Asia.

On the political side was the Jordanian government decision on the 31st of July 1988 to disengage from its administrative role in the West Bank. Since the majority of Jordanians working abroad are Palestinian in origin they stopped transferring money back to Jordan and the Palestinians inside Jordan started to transfer their funds out of the country⁸ (Guardian, 1989, p.10) (The Times, 1988, p.13). This reveals another impact of an important interest group in the country. The collective action of this Palestinian interest groups is more complex than that of the merchants because a large number of Palestinians (inside Jordan) are merchants and industrialists while others are workers abroad. The complexity of their actions is analogous with both economic and political criteria. Thus, as a result of the previous economic and non-economic factors as well as the devaluation of the Jordanian currency in 1988 and 1989, remittances declined from \$892 mn in 1988 to \$623.4 mn in 1989.

Further political spillover from the Gulf War of 1990/1991

⁸ This was one of the major factors that led to the devaluation of the Jordanian dinar in October 1988.

produced a decline in the number of workers abroad. An estimated number of 300 thousand returners came to Jordan from the Gulf states and particularly from Kuwait. However, those who came back brought with them all their funds. Thus, the figure for remittances increased from 406.3 MJDS (\$613.5 mn) in 1990 to an estimated figure of 795 MJDS (\$1168.6 mn) in 1991 (Central Bank of Jordan, 1992).

This vulnerability to external factors demonstrates the features of a semi-rentier economy without control of its major foreign revenue.

In comparison with other major labour exporting countries such as Bangladesh, India, South Korea, Pakistan and the Philippines, Jordan represents an extreme case of close dependency on the remittance transfers, as table (5.7) shows.

While Pakistan represents the most dependent on remittances among the other countries stated in the table, a comparison between Pakistan and Jordan reveals the extent to which Jordan is vulnerable to such transfers.

As table (5.7) depicts, both countries received approximately similar volumes of workers' remittances in 1977, but remittances as a percentage of GNP constituted only 4.3 percent in Pakistan contrasted with 31.8 percent in Jordan. In addition, as a percentage of total exports (goods plus services) they constituted only 46.6 percent in Pakistan compared with 256.2 percent in Jordan.

Table 5.7

The Relative Importance of Remittances in Major Labour Exporting Countries in Comparison With Jordan.

Details	Remittances \$ mn	Remittances/GNP (%)	Remittances/ Exports (%)
Bangladesh			
1977	61	0.8	16.1
1986	582	3.8	51.6
India			
1977	888	0.9	11.4
1986	3065	1.6	22.9
S.Korea			
1977	584	1.6	4.5
1986	1077	1.1	2.3
Pakistan			
1977	604	4.3	46.6
1986	3093	10.6	90.0
Philippines			
1977	213	1.0	5.0
1986	681	2.3	7.9
Jordan			
1977	609	31.8	256.2
1986	1029	18.5	56.1

Sources:-

1. For the countries except Jordan; Athukorala (1992)
1. For Jordan, the figures are calculated by the researcher employing the data in; Central Bank of Jordan (1989, table no. 47 and table no.21). Department of Statistics (1992, table no. 10/1/1)

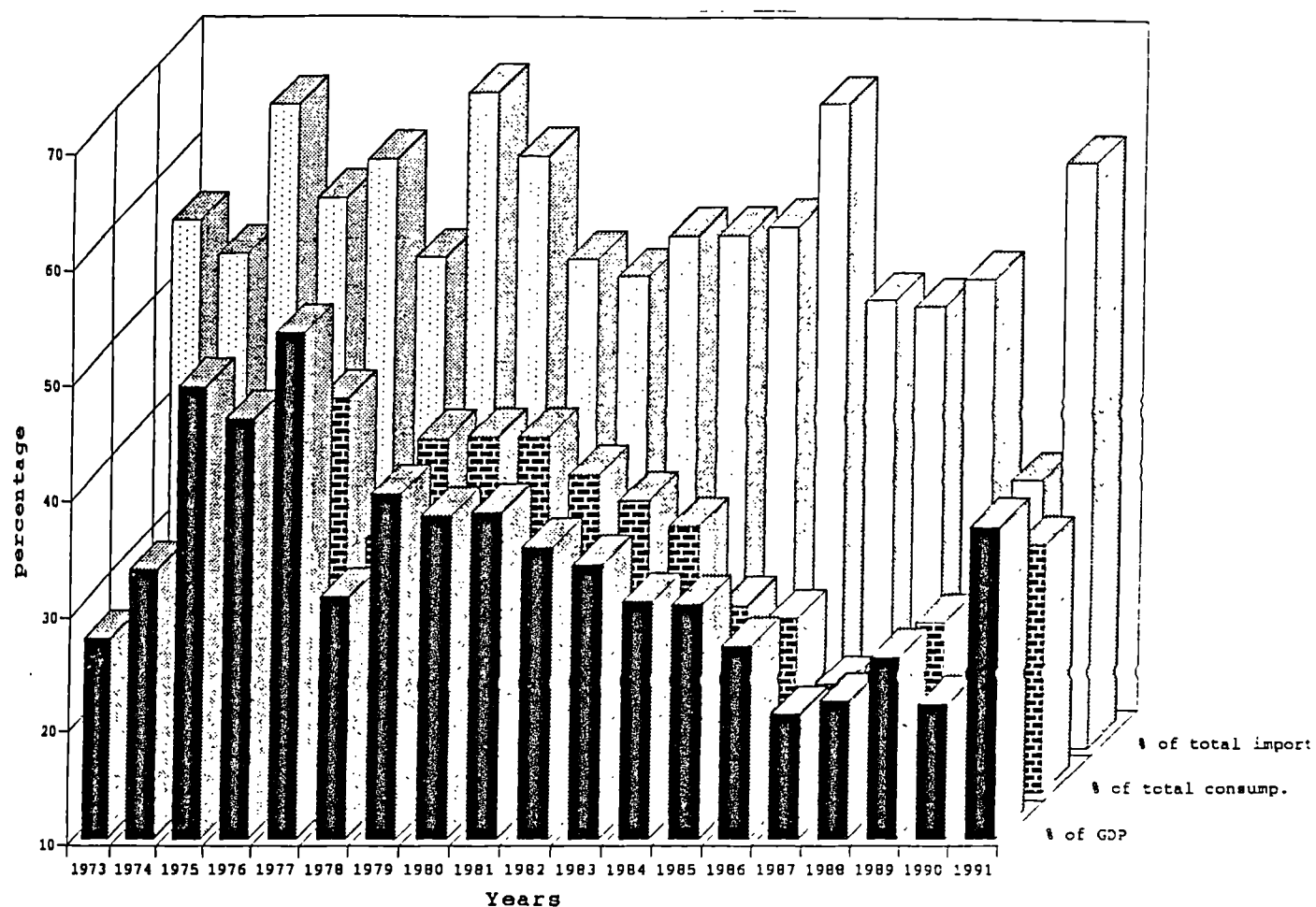
Even nine years later (1986) when remittances had increased fourfold in Pakistan and by less than 70 percent in Jordan, the share of remittances as a percentage of GNP was 18.5 percent in Jordan compared with only 10.6 percent in Pakistan. However, as a percentage of total exports, the relative importance of remittances reduced in Jordan to 56 percent while increasing in Pakistan to about 90 percent.

In making this comparison it is important to mention the difference in population size between the two countries (99 million in Pakistan against 2.8 million in Jordan in 1986). Another factor is the difference between the two in the quality of workers (the level of skills).

In Pakistan, most of the remittances were transferred by unskilled, cheap labour, while in the Jordanian case it is dependent on highly paid skilled labourers. Such differences in the features of migrant workers led Pakistan to be in a more favourable position than Jordan. That is to say, recession in the host countries, particularly in the Gulf rentier states, reduced the demand for workers with high quality and/or high wages towards those with lower skills and/or lower wages.

To sum up the importance of those two sources of external transfers (grants plus workers remittances) figure (5.15) provides a clear guide to their relative importance in the semi-rentier economy of Jordan.

Figure (5.15): The Relative Importance of Grants and Workers' Remittances to the Jordanian Economy (1973-1991)



Sources:

All data are calculated by the researcher employing the data;

- For imports from Department of Statistics (1992, table no. 19/1/1, p.434)

-For total consumption from Central Bank of Jordan (1989, table no.59, p.59) and Central Bank of Jordan (1992, table no.48, p.82).

-For GDP from Central Bank of Jordan (1989, table no.47, p.58) and Central Bank of Jordan (1992, table no.46, p.80).

-For grants and worker' remittances from sources of figure (5.14).

As a percentage of total imports both sources accounted to an average of about 55 percent during the period 1973-1991. Their importance as an indicator of total consumption reveals that they constituted 32 percent of the total consumption (private plus state) during 1973-1991.

In comparison with GDP, grants and workers' remittances constituted on average about 33.8 percent of the GDP during the same period.

Such measurements are analogous in their significance for the country's overall economic performance on the one hand, and the country's uncertain development derived from the dependency on them on the other.

5.4.4.3: Sources of Government Budget

Another feature of a semi-rentier economy is reflected in figure (5.16) which shows the heavy dependency of government budgets on external sources of finance.

Throughout the period 1973-1991, external revenues made up an important proportion of Jordanian governments' total revenue. During 1973-1980, the share was about 54 percent, while during the remaining years of the period (1981-1991), external revenue constituted on average about 38 percent. The main reason for this decrease was the decline in revenue received from abroad.

Because of this Jordanian governments were often more concerned with external events over which they had no power of control than internal one. This led to a greater

centralization of the decision-making process. The role of government⁹ was distributive rather than productive. A patron-client relationship prevailed between the decision makers and the people instead of one based on popular participation. That means the distributional interest groups in the country were trying to increase their share of the income rather than increasing the size of the income itself. Such a constitution is characteristic of a semi-rentier economy and a rentier state.

5.4.5: Indicative Planning

As mentioned earlier economic planning in Jordan was adopted not as a model of development but rather as a symbol and a fashion of development at the time, reflecting government commitment to economic and social development.

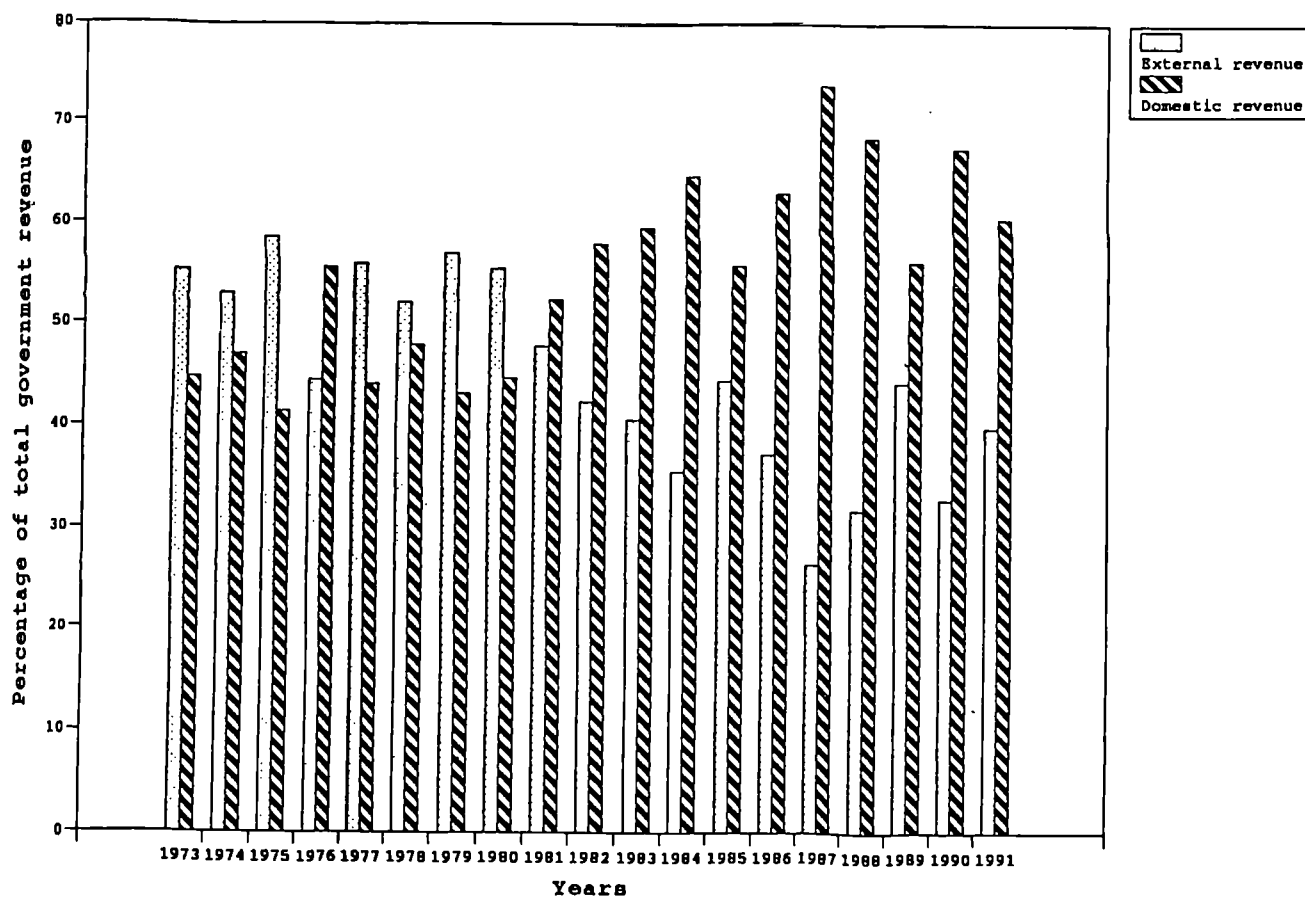
The major features of almost all of Jordanian development plans were the employment of a top-down approach of design and implementation, and high uncertainty in the achievement of their objectives. Different external and internal events led Jordanian plans to be unreliable and out of touch with the real capacity of the economy.

5.4.5.1: The Three-Years Plan (1973-1975)

This plan was formulated to tackle the problems arising

⁹More discussion on the role of government within the context of the rentier state follows in the next chapter.

Figure (5.16): The Sources of Jordanian Central Government Revenue (1973-1991)



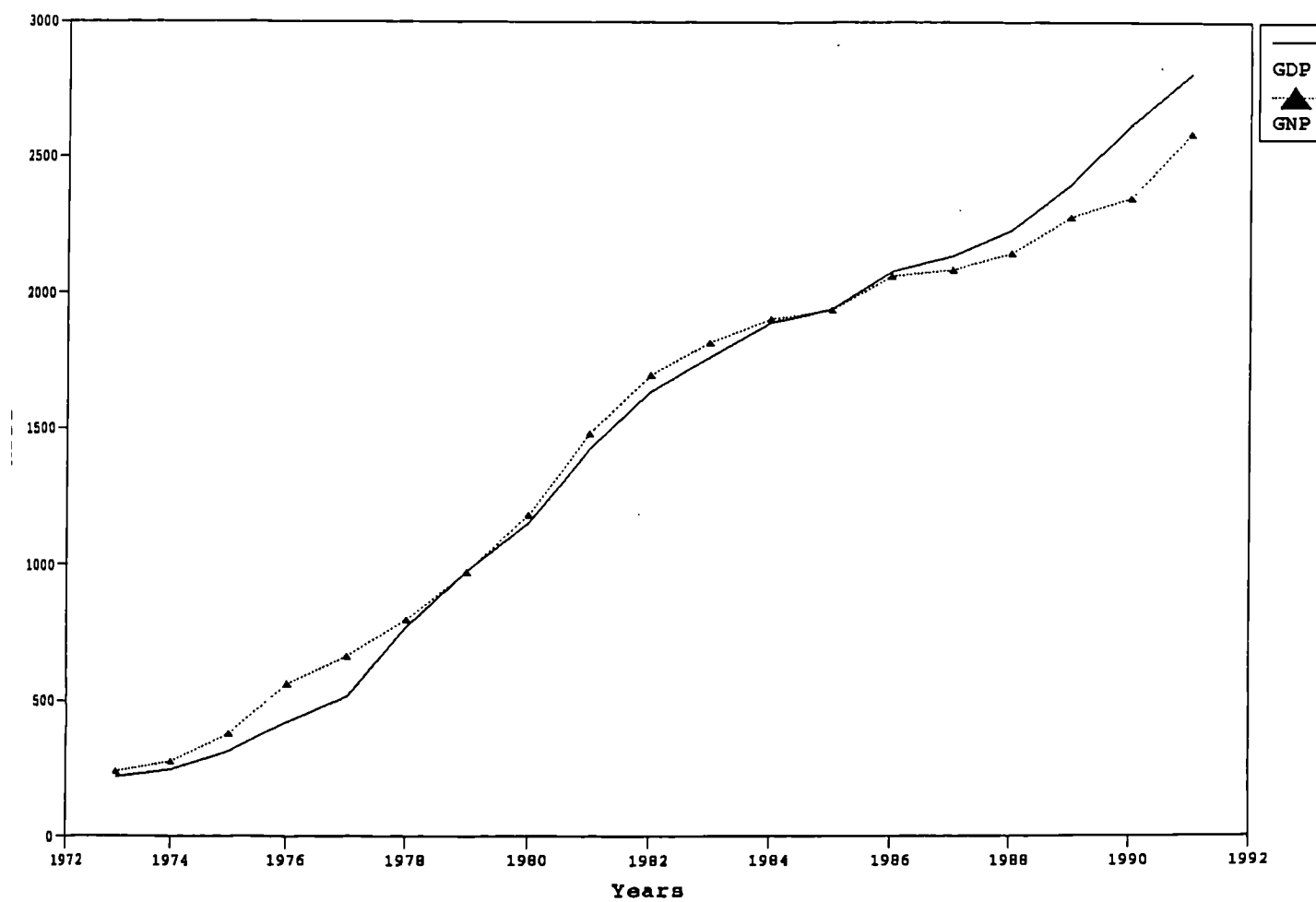
Sources: All data are calculated by the researcher employing the data in;
 -Central Bank of Jordan (1989, tables no. 37&38, pp.45-46).
 -Central Bank of Jordan (1992, table no.1, pp.4-5).

from the occupation of the West Bank or what might be called a "corrective adjustment" plan (Khader, 1990, p.87) Its main concerns was unemployment with the creation of 70 thousand employment opportunities (Ministry of Planning, 1986, p.11). The objective of an 8 percent annual growth rate of GDP was also set but never achieved. As figure (5.17) shows, GDP at market prices rose from 218.3 MJDS in 1973 to 312.1 MJDS in 1975 (Central Bank of Jordan, 1989). In real terms, GDP achieved an annual growth rate of only 5.9 percent. Inflation, [see figure (5.18)], reveals a substantial rise in the cost of living which was further exacerbated by land speculation. The latter was the result of two main factors; firstly, the Lebanese war which resulted in 100 thousand people been driven into Jordan leading to sudden increases in the money supply in an economy characterised by limited productive capacity as well as a mercantilism tradition (Khader, 1990, p.88). The second reason was the increase in workers' remittances transferred mainly to the families of those workers in Jordan. Both factors led mainly to investments in the construction sub-sector (infrastructure and housing) of which land speculation was traditionally an important component.

5.4.5.2: The Five-Years Plan (1976-1980)

The objectives of this plan were drawn in the light of two major factors of dependency. These were the increases in Arab grants and workers' remittances. The target of a real

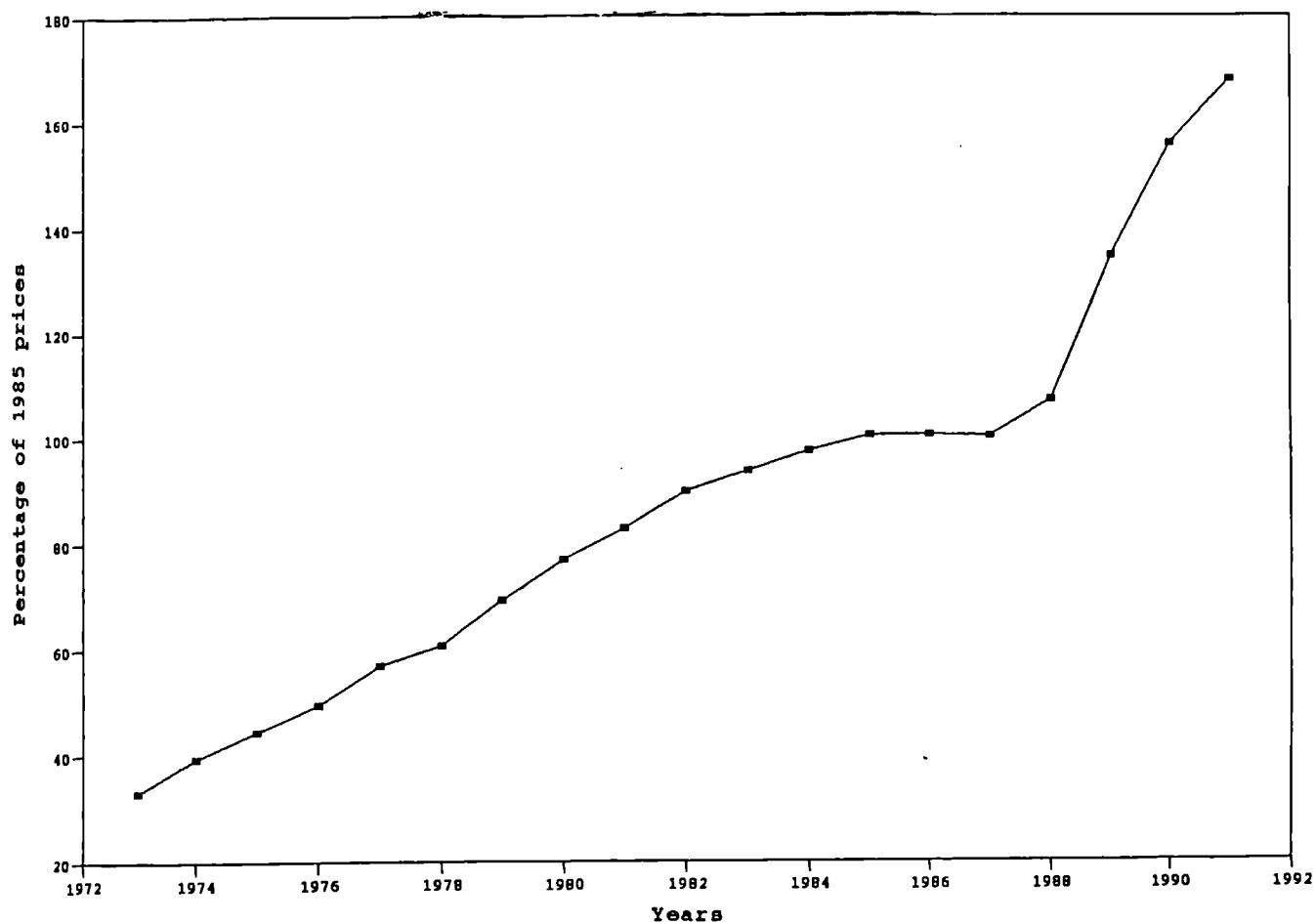
Figure (5.17): Nominal GDP and GNP Trends in Jordan (1973-1991)



Sources:

- Central Bank of Jordan (1989, table no.47, p.58)
- Central Bank of Jordan (1992, table no.46, p.80)

Figure (5.18): The Inflationary Trends in Jordan (1973-1991)



Sources:

All data are calculated by the researcher employing the data of consumer price index in Central Bank of Jordan (1989) and (1992).

annual growth rate in the GDP of 12 percent had demonstrated the case of dependency. However, other targets such as increasing the proportion of domestic revenue to the revenue (to 68 percent), a reduction in the trade deficit and a balanced regional development were never achieved because they were more related to the institutional characteristics of the economy rather than the availability of external resources.

Heavy infrastructural investment by the government was mainly concentrated in the urban areas, which led to even further urbanization and polarization. The problem in the economy never realised by either planners or decision makers was not the growth rate in GDP, but a solution for both the structural problem of inequality in the distribution of income and wealth and the uneven development between the regions.

5.4.5.3: The Five-Years Plan (1980-1985)

Planners in Jordan were too optimistic when setting their goals during this period. The reason for this was the presumption of continuing favourable conditions in the rentier economies of the region. But as oil prices declined, the projections of high external revenues were undermined. As a result, only half the targeted annual GDP growth rate of 11 percent was achieved. Additional factors were a decline in the world prices of phosphate and potash and increases in the prices of manufacturing inputs which led to higher costs on the economy (terms of trade

effect).

In addition to the above factors, Iraq, the traditional market for Jordanian manufacturing exports, decided, in 1983, on a major reduction in its imports because of the heavy burden of its war with Iran. This brought about the collapse of Jordanian exports to Iraq.

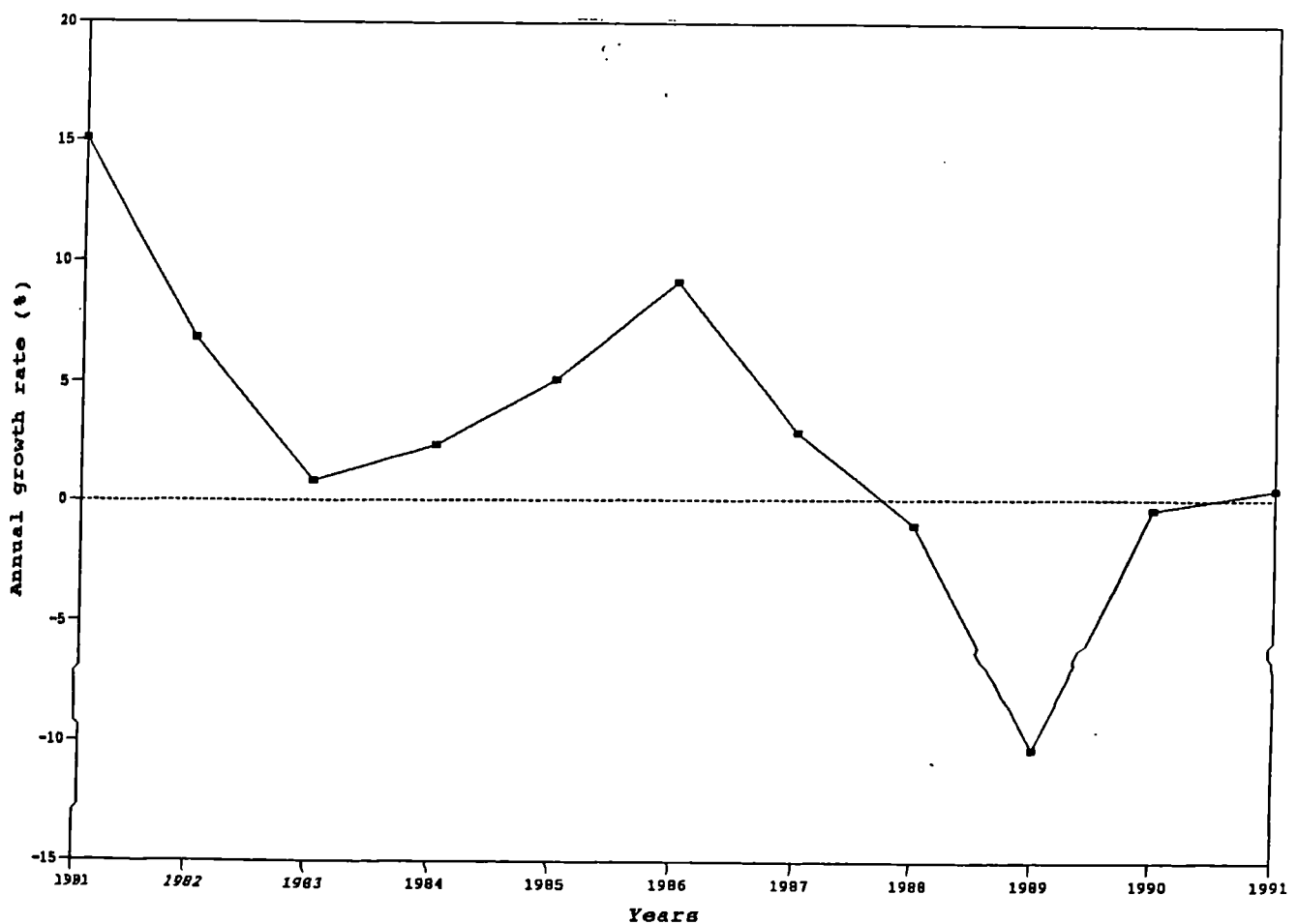
5.4.5.4: The Five-Years Plan (1986-1990)¹⁰

This plan could be described as regional (Ministry of Planning, 1986) but in reality it followed the traditional top-down approach which had prevailed in the previous plans. Promoting growth, reducing the trade deficit, and privatization were the main objectives. In reality, the GDP growth rates started to decline as the recession hit the rentier economies of the region hard and simultaneously the semi-rentier economy of Jordan. Real GDP growth rates declined from 9 percent in 1986 to only 2.8 percent in 1987. However, after 1987, GDP growth started to become negative with figures of -1% , -10.3% and -0.4% for 1988, 1989 and 1990 respectively as figure (5.19) shows.

The targets of growth, a reduction in the trade deficit, balanced regional development and popular participation all remains unachieved. However, the return of large number of Jordanian workers from the Gulf states as a

¹⁰Further discussion to this plan will follow in chapter 7.

Figure (5.19): The Changes in GDP Real Growth Rates in Jordan (1981-1991).



Sources: All data are calculated by the researcher by employing the GDP deflator data in IMF (1991, p.346) and IMF (1992, p.318).

result of the 1990/1991 Gulf war led to a mini-boom in the economy during 1991 and 1992. While the real growth rate of GDP in 1991 was 0.5 percent it increased to high 11.6 percent in 1992. The reasons were; first, the increase demand in the economy due to the large money inflow which led to growth in construction, insurance services, housing and government services sectors which affect positively the overall growth in GDP despite the negative growth in other activities such as mining, manufacturing, agriculture and transportation. The second reason for the high growth of GDP was the increase in government indirect taxation revenue (Ministry of Planning, 1994, p.4).

5.4.5.5: The Five-Years Plan (1993-1997)

Jordan did not introduce new development plans during 1990/1993 because of economically uncertain environment on the one hand and the unstable geo-political factors on the other.

However, in 1994 the Ministry of Planning published its new five-year development plan for the period (1993-1997). The objectives of the current plan are designed in the light of two major factors, namely the negative consequences of the Gulf war on the economy, and the change of emphasis in managing the economy following the structural adjustment programme agreed with the IMF in 1989 and 1991.

The target of a moderate 6 percent annual real GDP growth rate is set to increase per capita GDP during 1993-1997 by

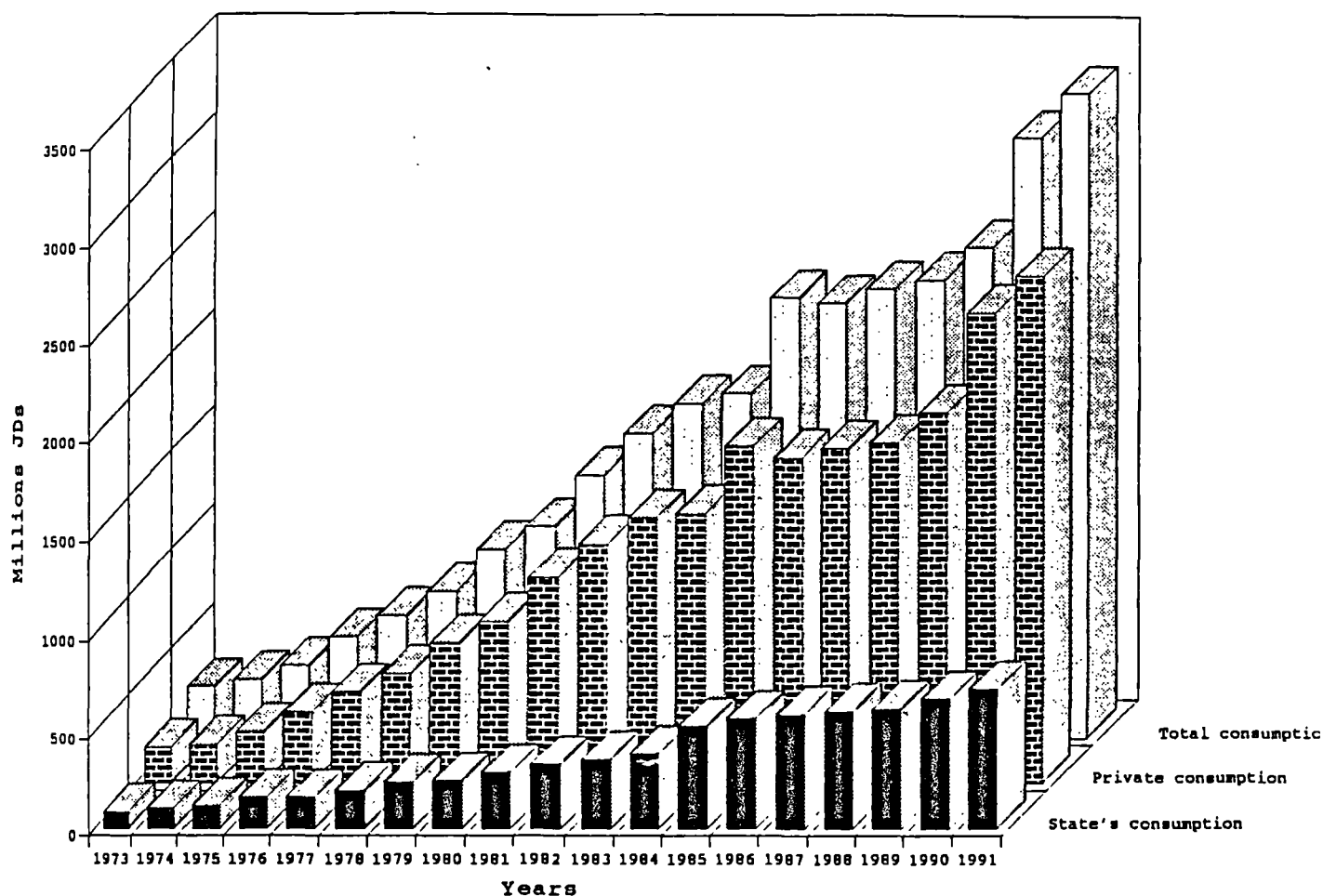
2.7 percent annually. Other objectives, such as cutting the budgetary deficit to 5 percent of GDP, balancing the current account in the balance of payments, cutting down the percentage of debt to GDP to not more than 100 percent, reducing the debt service ratio to 22 percent, and decreasing the proportion of total consumption to real GDP to 85 percent, are all goals included by planners in order to achieve the targets of the structural adjustment programme and enable access to new funds from international donor agencies. The planned emphasis on a greater role for the private sector in investment and the running of the economy are also evidence of such a context. Thus, the design and the goals of the plan are a continuation of the top-down development approach employed in the previous plans. The plan, however, seems to be asymmetric in its goals because during the past three years, the real problems of the economy became poverty and *unemployment* which cannot be reduced through policies directed to achieve the above targets.

To sum up: during this period economic planning in Jordan was responding to events rather than creating development.

5.4.6: High Consumption vs. Small Productive Capacity

Total consumption (capital+private) in Jordan increased sharply during the period 1973-1991. As figure (5.20) shows, the country's total consumption increased threefold during the first ten years (1973-1983), with private consumption constituting three quarters of the total,

Figure (5.20): The sectoral Distribution of Consumption in Jordan (1973-1991)



Sources: All data are calculated by the researcher employing the data in;
 - Central Bank of Jordan (1989, table no.59, p.59).
 - Central Bank of Jordan (1992, table no.48, p.82).

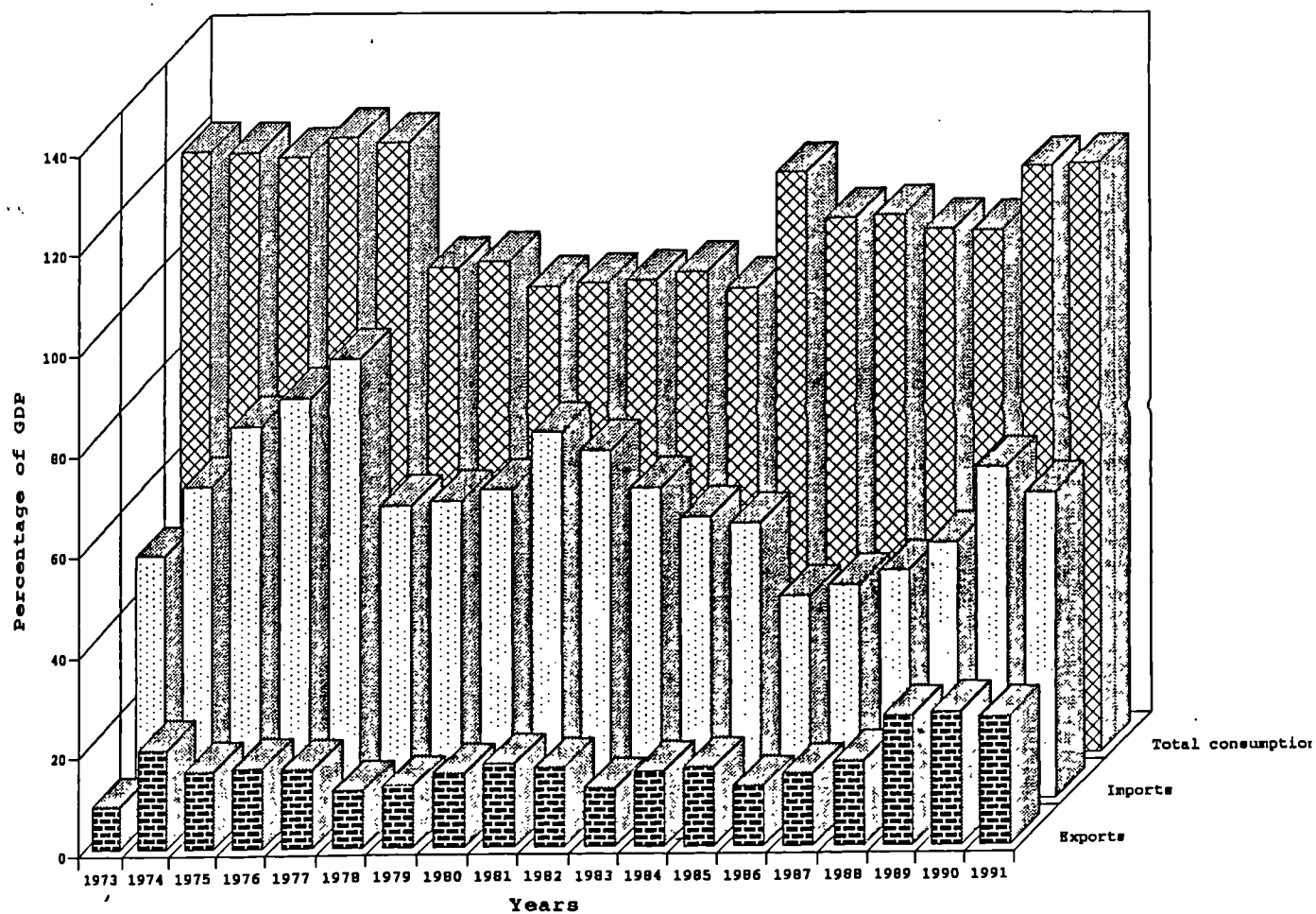
similar to the share in the first period (1959-1972). This expansion in consumption was supported by a sizable sum of external transfers from abroad (grants and workers' remittances) and favourable economic conditions within the economy. However, remittances alone constituted about 38 percent of total consumption in 1983.

When recession deepened after the mid-1980s, the productive capacity of the economy declined while consumption continued its rate of increase. This is because consumption in a subsidized economy such as Jordan's is often not related to the productive capacity of the economy. As a semi-rentier economy, external sources of finance have played a major role in shaping the pattern of economic behaviour towards consumption rather than production.

In 1973, consumption represented more than 120 percent of the country's GDP. The only time, it had a share of less than that of the GDP (95 percent) was during the most prosperous period of the Jordanian economy namely (1978-1984). But after 1985, consumption, as a percentage of GDP, rose dramatically as GDP started to decline [see figure (5.21)]. In the final year of the period (1991) it amounted to about 117 percent of the country's GDP (The Gulf crisis effect). This means that one of the main characteristics of this economy is that, "it has long lived above it means".

Other measurements of this propensity for could be derived by comparing import levels with GDP. On average, imports

Figure (5.21): Total Consumption, Imports and Exports as a Percentage of GDP in Jordan (1973-1991)



Sources: All data are calculated by the researcher employing the sources in figures (5.17) (5.19) and table (5.6).

represented about 61 percent of GDP during 1973-1991 compared with only 38 percent during 1966-1972. The share of exports to the GDP for this period, however, was on average only about 16 percent, an increase of barely 11 percent when compared with the average during 1966-1972. The explanation for this was a structural problem within the economy far beyond the capability of high GDP growth to solve.

5.4.7: The Debt Burden

The logical outcome of such high levels of consumption and imports was an accumulating burden of external debt.

What then is the size of the Jordanian's debt?

In 1970 Jordanian debt was estimated to be around \$134 mn (World Bank, 1987) but it grew to unprecedented levels during the 1980s. As table (5.8) shows, Jordan's total external debt rose to \$3.5 bn in 1984, constituting about three quarters of the country's GNP. As mentioned earlier, as long as the policies of high consumption and imports continued after the mid-1980s, the debt figures accumulated and became double those of 1984. In 1989 and 1990 and 1991 the economy's external debt had risen to \$7.4 bn, \$7.1 bn and 7.6 bn respectively. That is to say the size of the external debt was more than twice the country's GNP. At the same time servicing the debt consumed one-fifth of export earnings in 1990 and 1991. It was the policies of continuing dependency on the one side and living beyond the country's real means on the

other which left Jordan in such a difficult position.

Table 5.8

Jordan External Debt for the period 1984-1991.
(Million U.S. dollars)

Item ----- Year	Total external debt [1]	Public disbursed debt [2]	Total debt service [3]	[1]/GNP (%) [4]	[3]/ Exports (%) [5]
1984	3508	2832	452	73.5	13.8
1985	4153	3398	558	87.5	18.0
1986	5142	4307	641	87.2	20.8
1987	6605	5201	802	107.0	24.9
1988	6720	5500	1054	116.3	31.3
1989	7395	6365	565	181.5	18.8
1990	8328	7143	606	237.6	19.7
1991	8641	7570	638	225.3	20.9

Sources:-

- 1- Data for 1984 and 1985 from EIU (1992a, p.33)
- 2- Data for 1986-1991 from EIU (1993, p.37). Both are adopted from the World Bank, World Debt Tables.

As a result of this structural problem Jordan concluded a five-years structural adjustment package with the IMF in April 1989. Because of the Gulf crisis, however, a second agreement between the two sides was concluded in October 1991. The latter package was for seven years to last until the end of 1998.

The main objectives of the agreement were to reduce both deficits [current and budget (excluding grants)], reduce public expenditure, increase domestic revenues and reduce consumption. That is similar to the objectives of the current 1993-1997 development plan.

The social costs of the IMF package are too high, especially for the poor. Thus, in 1989 riots broke out in Jordan, particularly among the poorer regions of the south.

It is the Jordanian policy makers failure to choose the appropriate strategy for development which often led them to be crisis-driven agents rather than strategic planners and decision makers. These are the main reasons for the country's development failure.

5.4.8: The Social Development Indicators

In order to complete the assessment of Jordanian development efforts, a number of social development indicators need to be presented in this section.

5.4.8.1: The Distribution of Income

Although there was growth in the country's GDP and GNP during the first fifteen years (1973-1987) of this period, the measurement of income distribution can provide, at least, an indicative indicator of who benefited and who lost from the economy's growth.

The most recent study on the distribution of income in Jordan was conducted by Shamaielh (1990). It is based on data derived from the more recent household survey in Jordan (1987).

The study found that the distribution of individual income

was more unequal in urban areas than in rural areas¹¹. While the Gini coefficient was 0.37 in rural areas, it was 0.45 in urban areas. However, there is a large difference in per capita mean income between urban and rural areas. While it was about 626 JDs in the urban cities, it was 38 percent less in the rural areas. When comparing this divergence with the figures in 1973 [Saket and Asfour as stated in Khader (1990, p.91)], it is found that income in urban areas increased by 9.4 percent (from 572 JDs) while the average income in rural areas increased by 7.6 percent (from 362 JDs)¹². Thus on a regional level, the income increases seem to be providing greater benefits to urban areas in comparison with the rural ones'.

At the national level, the distribution of household incomes reveals that the top 10 percent received about 48 percent of the total income while the lowest 40 percent received only 19 percent of the total income. This demonstrates a severe inequality in the distribution of household income.

At the per capita income level, the top 20 percent obtained 54 percent of the total income, while the lowest 40 percent only 14 percent (Shamaileh, 1990, p.74).

So at the per capita income level, the distribution of

¹¹This is similar to the Al-Assaf (1979) conclusion in his study to the distribution of income in Jordan in 1973.

¹². This comparison has to be taken with caution due to the differences in the two studies samples.

income is worse than the distribution of household income.

A comparison¹³ of the distribution of household income ratio¹⁴ of Jordan (0.51) with other developing countries (World Bank, 1990) revealed the following. The distribution of income in Jordan was better than in Sri Lanka (1985-1986) and Malaysia (1987). However, it was worse than the distribution of income in countries such as Bangladesh (1981-1982), Indonesia (1987), India (1983) and Pakistan (1984-1985).

So, in Jordan the fruits of economic growth were redistributed in favour of the rich, and to a lesser extent the middle class, but the main losers were the poor.

The focus on growth in the economy during the last four decades, therefore, did not take into account the consequences resulting from unequal distribution of income. It seems that the rich became better off and the poor worse off since only 20 percent of the population received more than half the country's income. This emphasis on growth continue to be the cornerstone of the government's economic policy during the 1990s (Susser, 1992, p.463).

Such distributional status should be linked with the

¹³ The ratios are calculated by the researcher employing the figures presents in the World Development Report; Poverty (1990).

¹⁴The ratio of the lowest 40 percent to the top 10 percent.

initial phase of the "Land Settlement" programme (1957). As mentioned earlier in the chapter, the consequences of the implementation of this programme led to a more unequal distribution of income and wealth since most landlords are urban in origin and livelihood. This widened the income distribution between rural and urban on the one hand and within the urban areas on the other. This compares unfavourably with countries such as South Korea and Taiwan where initial land reform was the corner stone in the drive towards a more equitable distribution of the development gains.

5.4.8.2: Unemployment Rates

The state of unemployment in the country can be viewed as a reflection of the inappropriate economic policies of reliance on exogenous factors as constants in the equation of development and growth of the country.

Unemployment varied significantly within two different periods during 1973-1991 as table (5.9) shows.

The first period was from 1973 to 1982 when the unemployment rate started to decline. Oil prices had gone up and the demand for the skilled and educated Jordanian workers by the rentier economies of the region increased. The rate of unemployment declined from 11.1 percent in 1973 to 1.6 percent in 1976 and then rose to 4.3 percent in 1982. During this period the country experienced for the first time a role as importer of cheap labourers from neighbouring countries, such as Egypt, and from Asian

countries, such as Bangladesh, to fill the unskilled vacancies within the economy (Abu Zant, 1988). The number of foreign employees increased from 9.7 thousand in 1977 to 120 thousand in 1982 (Ministry of Labour, 1988).

Table 5.9

The Unemployment Rates in Jordan (1970-1991).

Year	Unemployment rate (%)	Year	Unemployment rate(%)
1970	13.7	1981	3.9
1971	13.8	1982	4.3
1972	14.0	1983	4.5
1973	11.1	1984	4.8
1974	8.0	1985	6.0
1975	4.9	1986	8.0
1976	1.6	1987	8.3
1977	2.2	1988	8.9
1978	2.9	1989	n.a
1979	3.5	1990	20.0
1980	3.5	1991	32.5*

Sources:-

1- Data for 1970-1988 from Ministry of Labour (Annual Reports, several Issues)

2- Data for 1990 and 1991 is estimated from EIU (1992a, p.9.)

(*) This figure is an average between 30%-35% which was estimated by the EIU (1992a)

The second period has been from 1983 until this day and is characterised by a decline in the demand for Jordanian workers from the oil rich Gulf states. However, the Gulf crisis in 1990/1991 resulted in the unemployment figures rising dramatically. While the official jobless rate

before the crisis was 20 percent, it is estimated to have stood at between 30 and 35 percent in 1991 (EIU, 1992a, p.15). On the other hand the official unemployment figure according to the Ministry of Planning stood at only 17.1 percent in 1991 (Ministry of Planning, 1994, p.75).

The problem of foreign workers has compounded the case of unemployment. Despite efforts to tighten up on foreign workers a straight substitution of local labourers for foreigners is problematic. Firstly because of the low wages often accepted by the latter and secondly because of the social barriers to manual and domestic work by the local labourers (Susser,1992).

However, before the Gulf crisis, Smadi and his colleagues (1987, p.96), in their study of the unemployment problem in Jordan concluded that unemployment in Jordan has resulted from different causes; they summarized the internal ones as follows;

"1.At the top of the list of internal factors has been the slow down in economic activities as a consequence of the sluggishness of domestic demand. And, in turn, the retreat of gross capital formation. Three major factors have affected adversely domestic demand, namely the decline in unrequired transfers, export proceeds, and growth rate of remittances of Jordanian workers abroad.

2.The significant growth in college and university graduates of unrequired specialization, leading to a notable excess in the labour supply of the domestic labour market.

3.The continuous inflow of guest workers into the country.

4.The rigidity of wages in the country.

5.The lack of suitable information system about job vacancies.

6.Behaviourial unemployment."

Nevertheless, they realized that the exogenous factors were the most weighted factors in the unemployment position of the country.

So, for the last seven years, the unemployment problem seems to have caused social problems on the one hand and pressure on government as the major employer¹⁵ of the work force on the other.

Thus, a mixture of economic and non-economic factors has led to a serious problem of unemployment in the country. According to the current five year plan, the target of unemployment was set to be reduced to only 9.2 percent at the end of 1997 (Ministry of Planning, 1994, p.92).

5.4.8.3: Other Social Development Indicators

A number of indicators are used in this section in order to assess the Jordanian achievements in the field of human development.

On the health side, the growth in health services and rising levels of health education resulted in a sharp decrease in the infant mortality rate from 78 in 1973 to about 41 in 1989 (World Bank, 1991, pp.346-347) and 39 in 1991 (Ministry of Planning, 1994, p.74). Although such an achievement could be described as remarkable, it still stands about three times higher than the rate in the developed countries.

However, there were two main reasons for the drop in this rate; Firstly, government provision of health services, particularly due to the large sum of revenues from abroad, and secondly the increasing degree of mothers' education.

¹⁵More discussion to the role of government in Jordan will follow in the next chapter.

Thus, as government services were more in urban areas along with the number of educated mothers, it is to be expected that the infant mortality rate would be higher in rural areas (Ministry of Planning, 1986, p.198). In general terms, government health policies have contributed significantly to the sharp drop in this indicator during the last four decades.

The total fertility rate indicator shows a decline between 1973 and 1989, from about 8 births per woman to about 6. The factors of education and a greater participation of women in the work force had contributed to this decline. Again the figures show a variance between the urban and rural areas where more traditional values live on and fertility rate is higher because of lower education and lower participation rate levels.

The life expectancy estimates in Jordan indicate that in 1973, the expected age was about 57.5 years increasing to about 66.6 years in 1989 (World Bank, 1991, p.346-347). This increase reflects rising levels of income and government health spending programs. But despite large expenditure on health, a sizable segment of the population has no insurance cover to protect them against the high costs of medical treatment (Ministry of Planning, 1986, p.213). Thus, national statistics might not give a real assessment of the disparities between the rich and the poor, urban and rural, or workers in state institutions

and others outside, such as wage labourers in urban areas and small farmers in rural areas.

The physician/population ratio estimates refer to an increase from 5 physicians per 10 000 population during a 15-20 year period to about 11.6 in 1989 (World Bank, 1991). The reason for this was a great demand for medical education because of the demand deriving from the rentier economies of the region (during the 1970s and early 1980s). However, there has since become an unacceptable surplus of graduates in the Kingdom this field who can no longer be absorbed by the regional demand as was previously the case. A high number of unemployed doctors has been the result. By contrast, there is a lack of interest in paramedical and ancillary studies which has produced shortages threatening the capacity of the health sector.

On the other hand the lack of services in rural areas as well as a lack of motivation has discouraged doctors from working outside the cities and particularly the capital Amman. Thus, most of the medical services in rural areas are based on medical units rather than hospitals.

On the educational level, Jordan has been a country of educated people with half the population enrolled in the different stages of education. As a result the primary school enrolment rate increased from about 89 percent in 1973 to 100 percent in 1989, as a direct benefit of

compulsory education Law enforced since 1961.

Simultaneously, the rate of enrolment in secondary school rose to 79 percent (ibid, p.161).

In addition, the illiteracy rate as a percentage of the population aged (15+) decreased sharply from about 67 percent in 1973 to only about 25 percent in the late 1980s, according to World Bank estimates. This is a reflection of two main factors; Firstly, the high percentage of the population under the age of fifteen (about 50%), and secondly the number of students (about half the population). Thus, it was to be expected that the illiteracy rate would fall during the period. This demonstrates government effort in increasing the number of educated people, but as mentioned earlier, the policies were shaped by regional requirements did not reflect the economy demand. For that reason many shortages arose at the semi-skilled level, while there was a surplus in others of academic speciality.

5.4.8.4: Rising Poverty

One of the important dimensions in studying poverty is to identify if there is any evidence for polarization in the country. It is important to realize the relationship between the population, labour force and land.

Jordan comprises eight governorates and Amman is the capital city. Table 5.10 identifies the distribution of population and labour force among the governorates.

Table 5.10

The Distribution of the Population (1991) and Labour Force (1987) Between Jordan's Governorates.

Governorate	Share (%) of 1991 population	Share(%) of 1987 labour force
Amman	40.4	41.1
Zarqa	15.4	14.3
Irbid	24.4	23.6
Mafraq	4.1	3.4
Balqa	6.9	6.3
Karak	4.2	5.4
Tafila	1.6	1.8
Ma'an	3.7	4.1
Total	100.0	100.0

Sources:-

1. Population data from Department of Statistics(1992, p.20)
2. The shares of labour force are calculated by the researcher, employing the data from Ibrahim, et al. (1989, p.29).

It is apparent from the table, that Amman, Irbid, and Zarqa comprise 80.2 percent of the population and 79 percent of the labour force with half of these in the capital city Amman. Such polarization in the three cities in general and Amman in particular, was due to two main reasons.

The first stem from the internal migration from rural to urban areas because of the attractiveness of the city and the greater availability of services. This is particularly true in the case of the capital.

During the period 1969-1989, the urban population percentage increased from about 50 to 67.4 percent (World Bank, 1991).

The second reason has its origins in nature. As 80 percent of the country is desert, the sedentary population is concentrated in the northern and central highlands. There the major towns are located near the River Jordan and the rain fall is sufficient to support cultivation. Nevertheless, the effect of internal migration has been the stronger and was identified by the economic specialists (Planners) in the Fifth Year Plan (1986-1990).

The economic policies of the 1970s and 1980s were the major cause of this unbalanced demographic distribution. Thus, it was the uneven distribution of services and job opportunities caused by the concentration of investment in the capital city which brought about the polarization problem.

Another aspect of poverty can be observed by reading the changes in the average real per capita income although this is not a precise indicator. Table (5.11) shows that there was a declining trend in the real per capita income in the country (in 1985 prices). Between 1986 and 1991, real per capita income fell by 39 percent, from 62.5 JDs monthly to about 38 JDs monthly in 1991.

Another indicator of people's hardship in the country is the inflation rate or the retail price index. The annual increase in consumer prices (1985=100) was 33.8%, 55.4%, 68.1%, and 174.9% in the years 1989, 1990, 1991 and 1992

subsequently (Ministry of Planning, 1994, p.15)).

Table 5.11

Real Annual Per Capita Income in Jordan
for the Period (1980-1991)
(JDs)

Year	Real per capita income (1985=100)
1980	675.0
1981	756.0
1982	775.6
1983	743.8
1984	716.9
1985	718.8
1986	750.3
1987	733.5
1988	689.1
1989	588.7
1990	499.1
1991	457.8

Source:- Calculated by the researcher, employing the data of GNP and GDP deflator of 1985 from the IMF (1991) (1992).

Such rises in prices often affect the poor rather than the rich in a country characterized by an uneven distribution of income and wealth.

The above assessment is based on the supposition that people living in the southern regions constitute a large proportion of the poverty ratio. When price increases followed the country's agreements with the IMF in 1989, riots broke out in the poorer regions of the south, in

Ma'an, Karak and Tafila (Guardian, 21st April 1989). Thus it seems that the poor are more concentrated in the south and in the north eastern city of Mafrag.

Cardoso and Helewege (1992) argued that

"Economic poverty reflects political poverty: the poor lack the means for voicing their demands, as they possess neither capital nor trade union power"(p.19).

Thus, in Jordan the peasantry, organized and unorganized workers are weak both because they are poor and because the other interest groups who denote the government elite are more powerful.

Another dimension is the people living below the poverty line. According to some commentators (EIU, 1992a, p.9), the percentage of people living below the poverty line during the mid-1980s until 1988 was estimated at between 25 to 30 percent of the population. Another international organization Unicef, estimated in a report published in 1991, after the Gulf crisis, that the crisis had wiped out 50,000 jobs in Jordan. It stated that the number of people living below the poverty line (less than \$135 monthly income per household) has risen sharply, to almost one in three, which is more than one million people. It also suggested that 150 thousand people may fall within the class of "absolute poverty" with almost no income (The Independent, 28 February 1991, p.4).

Thus, the available statistics reveal that there is strong

evidence of poverty in the country, before and after the Gulf crisis. However, the current conditions of poverty seem to be the major challenge for the government because the number of poor is increasing rather than decreasing¹⁶. The number of poor was estimated to be 1.3 million people in 1992 (Al-Qudus, 1993, p.4).

Such phenomenon marked the failure of development despite major achievement in other human development indicators. That is because poverty means less capability on the side of individuals to choose their destiny and well-being.

5.5: Conclusion

The focus of this chapter has been the evaluation of the Jordanian economy. As a small country, with a traditional merchant business culture, the Jordanian economy has been a hostage to powerful interest groups which play an important role in shaping the sectoral structure of the economy. Because traders, bankers and middlemen are the powerful interest groups, the economy has been dominated by the service sector. The other major effect of these interest groups has been a negative one on the agricultural sector.

The "land settlement" program in 1957 was a major factor which contributed to the widening of income and wealth

¹⁶ In an interview with one of Jordanian's member of Parliament, Mr. Altaema, and the Jordanian Minister of social development, Mr. Mashakba, They both have admitted that poverty is increasing in the country and the government should employ a solution wider than the one depend on giving money to support the poor (Al-Qudas, 1993, p.4).

distribution in the country. It had also led to increased resistance to reform and change (i.e. overvalued exchange rates and ISI policies).

As a small market, there are many constraints on the existing industrial sector. ISI was forced on the country during the 1950s and 1960s, due to the high transportation costs caused by the 1948 war. Nevertheless, ISI during the 1970s and early 1980s became a choice that had negative effects on the economy. The first effect was the dependency on external markets to provide inputs, the second was the weak linkage between the productive sectors of the economy.

This case study has shown that there are internal constraints on the economy (structural, demographical and geopolitical). Other forces of constraint are the exogenous variables (Arab aid, worker remittances, oil prices and regional politics spill-over).

Because of the factors above the Jordanian economy is a semi-rentier economy. Its heavy dependency on unstable and uncontrolled foreign transfers have made the country and its development vulnerable to exogenous economic and non-economic factors.

The dilemma in development is how to conduct economic policies which suit the country's features and capacities. This is the responsibility of government in a centralized and rentier state such as Jordan.

The conclusion drawn has been that the country's economic policies were basically depend on exogenous variables rather than internal ones. Decision-makers thought that favourable external factors will continue to provide them with external resources that cover up the mismanagement of the economy. For example, the education policies were a reflection of a demand from the neighbouring countries during the boom years of their economies (oil Gulf states).

The consumption and import policies were beyond the country's productive capacity. The unequal distribution of services and employment opportunities led to the problem of polarization in the country.

Dependency is a feature of development in the country. This has led to the path of debt. Meanwhile, because of this dependency the country is suffering from a high unemployment rate as well as a real crisis of poverty.

Although health and educational indicators refer to success in the field of human development, this success should be assessed within the context of dependency on external sources of finance on the one hand and the government's distributional role on the other.

In summary, there is a failure in development. This assessment is based on the statistics of negative growth rates, declining real per capita income, unequal distribution of income, increases in the cost of living, rising poverty and the polarization of the economy.

That means, the current attempts to provide a universal solution to the problems of developing economies and Jordan as a case study based on neoclassical prescriptions of privatization, liberalization and openness are seriously misguided in that they neglect the major role of institutions and history on which opportunities and constraints can be presented. This contextuality to the Jordanian case was the task of this chapter.

Thus, the alternative approach for development in Jordan has to be one from within the country rather than a development from above. Within this context, does privatization provide an answer to the illness of the economy. That will be the question addressed by the chapter follows.

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Chapter 6

Privatization in Jordan

6.1: Introduction

6.2: The Role of the State

6.3: Objectives and Reasons For Privatization of SOEs

6.4: Performance of State-Owned Enterprises (SOEs)

6.5: Privatization Progress to Date

6.6: Obstacles to Privatization

6.7: Conclusion

6.1: Introduction

In the preceding chapter the evaluation of the Jordanian economy suggested reasons for the negative outcome of the continuous development efforts in that country. In this chapter, therefore, it is important to identify the role of the state sector in the economy in order to assess its significance at the macro level (spending and tax ratios), its regulatory role and its share in the means of production. Such an approach makes it necessary to examine why the introduction of privatization was proposed.

The following questions will therefore be raised: Why has privatization been included within the agenda of economic reform? It will be asked whether this implies a change in ideology or is the result of other factors related to the worsening state of the economy.

Privatization through change of ownership has not yet been implemented in Jordan, but the country seems to be nearing a moment of truth. Three industries in principle have been selected for privatization since 1986; Royal Jordanian Airlines (RJ), the Public Transport Corporation (PTC), and the Telecommunication Corporation (TCC), but despite their selection no steps of actual privatization have taken place.

This chapter will record for the first time the announcement of government officials about the privatization programme from its first initiative to the end of 1993. Many of these refer to the difficult tasks of design and implementation.

Another aim of the chapter is to examine the economic and financial performance of SOEs in Jordan. This part of the analysis will be divided into two sections, one for the performance of SOEs in general and the other devoted to an examination of one particular state enterprise in the electricity sector. Jordan Electricity Authority (JEA) will provide further empirical evidence on whether there is a relationship between ownership form and performance. Another goal is to differentiate between the economic efficiency of the enterprise and its financial performance.

Further enquiry will be conducted into the reasons behind the poor performance of many public enterprises. Are they exclusively related to the geometry of ownership?

Given the long time since privatization proposals were introduced and the poor financial performance of many enterprises, there should be specific factors which are hindering the implementation of a divestiture programme in Jordan. The following part of the chapter makes a tentative attempt to deal with this subject.

A number of conclusions have to be drawn from the Jordanian experience of suspended privatization. One of these requires emphasis, namely that the merits of privatization should not be judged by its success in developed countries but rather through a study of the economic and non-economic factors affecting the design, implementation and results within a particular context. This can provide a more solid basis for an appropriate

understanding of the problems and the right methods of solving them.

6.2 :The Role of the State

In order to study the role of the state in the Jordanian economy this section divides such a role into three different parts, the first related to government spending, the second to regulation and the third to government ownership.

6.2.1: Government Spending

It is often argued that the government spending ratio (or public expenditure ratio) can give an impression about the level of the allocative role of the government, in particular when the expenditure is divided between current and capital.

Table (6.1) provides statistics on the composition of government spending in Jordan (current and capital) as well as its share of GDP . The first impression which can be gained from the table is that the ratio of public expenditure during the period 1980-1992 was high, on average it constituted about 38.6 percent of GDP during the period 1980-1991. It is known that government spending affects the demand side in the economy as well as the balance of payments. As the recession became apparent after the decline in oil prices in 1986 with its subsequent effects on the economy, the government spending

ratio increased to counter the slowing down of the economy. However, the high percentage of government expenditure in Jordan must be linked with the external grants and revenues collected by the government from the boom years of the 1970s to the beginning of the 1980s.

Table 6.1

**Jordanian Government Spending and Its Share of the GDP
for the Years 1980-1992**

Detail ----- Year	Government Expenditure (MJDs)[1]	Current Expenditure (%)[2]	Capital Expenditure (%)[3]	[1]/GDP (%)[4]
1980	487.94	62.6	37.4	40.8
1981	546.17	65.2	34.8	38.6
1982	631.99	71.4	28.6	39.4
1983	656.28	69.8	30.2	37.3
1984	640.64	78.2	21.8	34.3
1985	713.44	73.9	26.1	37.6
1986	770.13	80.5	19.5	37.7
1987	825.71	71.2	28.8	39.5
1988	910.87	79.6	20.4	41.4
1989	947.92	79.7	20.3	37.3
1990	1033.7	81.8	18.2	40.2
1991*	1112.0	81.5	18.5	38.8
1992*	1348.4	74.0	26.0	n.a.

Sources:-

1- Data of column [1] from IMF (December 1986) and (May 1992b).

2- Columns [2] [3]: Calculated by the researcher employing the data in the IMF (1991a).

3- Column [4]: Calculated by the researcher employing the GDP data in the preceding chapter.

4- The data for 1990, 1991 and 1992 from EIU (1993, p.28).

(*) Preliminary.

In comparison with the South-East Asian countries, for example South Korea, the average annual government spending ratio during the period 1981-1991 was 38.4 percent in Jordan and 16.6 in South Korea respectively. The ratio was also relatively higher than that in Malaysia (31.2 percent on average during 1981-1990)¹. Such a high level of expenditure was based on a combination of expansion in expenditure during the boom years of high revenues and an inability to control or reduce this during the period of economic decline.

Thus, the problem for Jordan was not the level of government expenditure but the limited capacity of the economy to finance it. As a result, the country was left with a large external debt accounting for more than 200 percent of the country's GNP in 1990 and 1991 and the consequence was a very unstable economy².

The other important question is whether this expenditure was spent efficiently or not. A precise answer to this question may not be possible; however, the failure of the development effort might provide a large part of the answer as the next section will illustrate.

Another important indicator for the presence or absence of a sound economic policy is the share of current and capital expenditure to total governmental spending. Where

¹ The figures for South Korea and Malaysia are calculated by the researcher employing the data in IMF (1992a, pp.92-93), while for Jordan from table 6.1.

²See chapter 5, Jordanian external debt.

current expenditure has a large share, there is less of a commitment to development and vice versa. The classification itself may not be the same in different countries but in the case of Jordan there is further evidence about the status of the developmental or capital expenditure. Table (6.1) depicts the share of current and capital expenditure in the total governmental or public expenditure. The proportion of current expenditure constituted on average about 3/4 of the total spent during the period 1980-1992. This reflects two important facts; the first is that government current spending has been excessive because of the high level of military expenditure [(25 percent on average as illustrated by table 6.2)] and the enormous government wage bill. The latter is so large not because per capita wages are high but because the government employs over 48 per cent of the Jordanian work force in its service sector (EIU, 1992a, p.15). This is an example of deficient centralization as more central units of government need more government spending although the economy itself is market oriented. Another conclusion is that the private sector itself does not possess enough capacity to be able to participate significantly in absorbing the labour force into the economy.

The second fact is derived from the lower share of spending on the capital category itself, which is vital in classifying the merits of government economic policies. Since income uncertainty has been an important

institutional factor in the Jordanian economy, because of its dependency on exogenous sources of finance, capital expenditure has been used as a sinking account with much of the spending made in the last quarter of the year (Ministry of Planning, 1986).

Table 6.2

Jordanian Government Spending By Function
During the Period 1981-1990 (%)

Detail ----- Year	[1]	[2]	[3]	[4]	[5]	[6]	[7]
1981	25.3	17.7	7.6	3.7	13.7	28.3	3.7
1982	24.8	12.4	10.4	3.7	16.4	28.6	3.7
1983	25.6	11.2	11.5	3.6	12.5	n.a	n.a
1984	27.7	11.1	11.3	4.2	13.7	24.8	7.2
1985	26.7	12.2	12.2	3.8	7.7	22.4	15.0
1986	30.3	11.4	13.7	4.2	9.0	18.1	13.3
1987	26.5	8.6	13.0	5.4	8.4	15.7	22.4
1988	25.9	6.9	15.3	4.1	8.8	14.6	24.4
1989	23.1	6.4	14.2	5.8	9.7	12.9	27.9
1990	21.3	4.7	14.7	5.0	15.7	10.3	28.3

Sources:

All the figures are calculated by the researcher employing the data in IMF (1991)(1992).

[1] Defence; [2] General public services; [3] Education; [4] Health; [5] Social security & welfare; [6] Economic affairs & services; [7] Others (include public order & safety, housing, Amenities, recreation & culture and religious affairs).

This might explain the reduced commitment of policy makers to cut current spending while devoting the necessary resources to development.

Westphal (1990) argued that the relevance of the Korean development success to other less developed countries is limited

" ...mainly because following them requires an overriding commitment to meaningful economic development, a commitment that few political leaders of less developed countries appear capable of making" (1990, p.58).

In other words, to treat development resources as a sinking account is like giving second priority to the commitment to development in the country.

One of the challenges for policy makers in Jordan must be to choose policies which suit the needs of the people, particularly the poor who constituted one third of the population in 1990.

While neo-liberal economic theory would suggest that distributional objectives should, as Lal argues (1992, p.30), be pursued through the use of the fiscal system such as taxes, direct cash transfers and subsidies. It seems that such policies have been lacking in Jordan. Shamaileh (1990) in his study of the impact of government egalitarian policies in Jordan found that four taxes (income, property, gasoline and customs) had an insignificant impact on the relative distribution of households among the income brackets (p.171) as well as on the poverty gap (p.176). This is because government high dependency on indirect taxation (in particular customs

taxes) to maximize revenues, taxes which do not discriminate between the different income brackets.

Table (6.3) asserts that during the period 1980-1990 the share of indirect taxes within total tax revenue was on average about 76 percent. Another important indicator is the share of taxes on international trade and transactions within total revenue collected from indirect taxes. This was on average about 65 percent of total indirect taxes collected by central government.

An explanation for such a phenomenon is that in a country like Jordan revenue maximization is the overriding concern of the government subject to the constraint that the burden of taxation must not fall on the government elite. There is a desire for taxes which minimize collection and other transaction costs, particularly where the collection of such taxes is facilitated through certain trade channels of the country (i.e. ports). Johnson (1975, p.57) denominated such taxes as a "corruption tax" which do not reflect the relative profitability of the different economic activities within the economy. It is, therefore, socially inefficient because it does not reflect changes in the social opportunity costs.

The table, however, reveals a marked change in the revenues collected from direct taxation, the result of a government decision to tax the mineral fertilizer industries whose products are priced in dollars and export oriented. As a result corporate taxes increased from 29.8 MJDS in 1989 to 88.7 MJDS in 1990 (IMF, 1992, p.318).

Table 6.3

The Origins of Tax Revenues to the Jordanian Central Government and their Relative Importance (1980-1990)

Detail ----- Year	Total tax revenues (MJDS) [1]	Direct taxes * (MJDS) [2]	Percentage of total taxes (%) [3]	indirect taxes ** (MJDS) [4]	Percentage of total taxes (%) [5]	Internati. trade taxes (as % of 4) [6]
1980	164.8	43.1	26.1	121.7	73.8	83.1
1981	214.2	59.8	27.9	154.4	72.1	80.0
1982	250.2	66.1	26.4	184.1	73.6	76.4
1983	274.1	69.8	25.5	204.3	74.5	68.6
1984	285.8	71.0	24.8	214.8	75.2	64.3
1985	304.7	74.9	26.4	229.8	75.4	59.2
1986	291.6	64.9	22.2	226.7	77.8	57.5
1987	292.0	54.7	18.7	237.3	81.3	60.5
1988	322.0	58.7	18.2	263.3	81.8	63.2
1989	364.6	72.3	19.8	292.3	80.2	52.4
1990	508.4	135.6	26.7	372.8	73.3	50.2

Source:

-Data of 1980 in columns [1] [2] and [4] from IMF (1991a) and for 1981-1990 from IMF (1992a) (Government Finance Statistics Yearbook).

-Data in columns [3] [5] [6] calculated by the researcher employing the data in the sources above.

(*) Direct taxes include tax on income, profit and capital gains plus property taxes.

(**) Indirect taxes include domestic taxes on goods & services, taxes on international trade, transactions and others.

In contrast, there was a reduction in the indirect taxes collected from international trade and transactions. The reason for such a trend in 1989 and 1990 was the effect of the structural adjustment plan on the choices of the government. Under this plan, which was signed in 1989, the Jordanian government turned to local indirect taxes as a means of reducing demand on the one hand, and to prove to

the IMF its intention of reducing trade barriers on the other. Such policies were not a choice but a condition imposed on Jordan by the IMF. This analysis is consistent with the argument of Levi (1988) who believed that rulers are revenue maximizers subject to changing constraints. The constraint in the case of Jordan was the IMF structural adjustment programme. This forced the leaders to adjust their ways of revenue maximization because the programme in itself provided a new way of maximizing revenue through the loans given to Jordan³.

Another revelation from Table (6.2) is that the share of government spending on social security and welfare was limited, less than 10 percent of total governmental spending during 1985-1989. Such figures reflect the absence of welfare state schemes to provide the poor with effective help parallel to those existing in the welfare states of western countries or those suggested by the World Bank in its report on the problem of poverty in developing countries (World Bank, 1990)⁴. Thus, public enterprises are the major means for the state to provide people with income for equity reasons and this fact needs to be taken into account when discussing privatization in Jordan.

³ Further analysis of the predatory rule of the state is provided by the first chapter under the transaction cost theory and institutional change.

⁴For more details regarding the effect of social security schemes on income distribution in Jordan, see Musallam (1990).

Nevertheless, the Jordanian state spent a good proportion of its total expenditure on education and health. For example in education it spent on average 12.4 percent during 1981-1990 which constituted 4.8 percent of the total GNP during the same period. Although no one can argue against such human investment, government policies in education until 1990 never addressed the real need of the Jordanian economy, middle level practical skills, but concentrated more on professional academic skills. As a result the highly educated people in the country suffer from unemployment.

If modernization is based on imitating the trends in advanced countries, as is the case in education, any country, not only Jordan, will fall into the trap of cultivating the unemployment of a highly educated workforce.

In health, the proportion of expenditure was about 4.3 percent of total government expenditure during the period 1981-1990 and only 1.7 percent of the total GNP for the same period.

Thus, the social allocation ratio, which is the relative importance of health and education expenditure to the GNP, seems to be low (UNDP, 1991, pp.44-45)⁵. The problem in health, however, is not the spending but the quality of the spending. The health system is hospital oriented.

⁵Calculated by the researcher by employing the expenditure data in table 6.1 and table 6.2 and by employing the GNP data for Jordan from the Central Bank of Jordan (1989, table no.47, p.58) and the Central Bank of Jordan (1992, table 46, p.80).

Expenditure on hospitals accounted for 75-80 percent of total expenditure in the Ministry of Health's budget during 1984-1988 while expenditure on primary health care constituted only 12.5 percent. About 90 percent of total health expenditure in Jordan (including that by the military medical services, University hospitals and the private sector) was directed towards the non-primary health services (Kharabsheh, 1990, p.141). Another problem is the uneven distribution of such services among the rural and urban areas. The rural regions, particularly in the south, suffer from shortages in hospitals as well as technicians (EIU, 1993, p.12). More than 63 percent of the physicians are based in Amman while most of the remaining are based in four urban centres (Zarqa, Irbid, Salt and Karak) (Kharabsheh, 1990, p.142).

Such evidence demonstrates the inability of a centralized policy to match the needs of people desperate to enhance their range of choices and entitlements according to the Sen (1992, p.15) concept of development. This implies that health services should be directed towards primary services and to a more even distribution among the regions.

Although capital expenditure is not the same as government fixed capital formation (or government investment), it is closely related to it. Table (6.4) provides the statistics for government as well as private investment and its share of GDP. The table reveals the following:

In the first place private investment constituted an

important share of total investment, particularly before 1986. On average its share was 62 percent during 1980-1990. However, as short-term profit is a feature of private activity, or the economy in general, investment was mainly in the construction sector (buildings) and transport rather than capital equipment for industry (Central Bank of Jordan, 1989).

Secondly, government investment was limited, on average to about 9 percent of GDP. What then are the areas of government investment? According to the Jordanian Ministry of Planning most government investment is concentrated on two sectors, namely infrastructure (construction, transportation, telecommunication, energy and irrigation) and the social and services sectors (health, education, housing and government buildings) (Ministry of Planning, 1986, p.97).

Thus, according to the normative theory of public sector intervention, such intervention through public spending seems to be consistent with the policies advocated by the market proponents. The question is whether there is another role for the government which affects private activities more than is apparent from public spending measurements.

6.2.2: Government Regulations

The UNDP (1993, p.52) has argued that private entrepreneurs in developing countries are less concerned about government spending than with government control.

Table 6.4

Jordanian Gross Fixed Capital Formation (Governmental and Private) and Its Relative Importance to the GDP During the Period 1980-1990.

Detail ----- Year	Total GFCF (MJDS) [1]	Government share of GFCF (%) [2]	Private share of GFCF (%) [3]	Government GFCF/GDP (%) [4]	Private GFCF/GDP (%) [5]	Total GFCF as (%) of GDP [4+5] [6]
1980	397.8	33.2	66.8	11.1	22.2	33.3
1981	564.8	33.2	66.8	13.3	26.6	39.3
1982	597.0	30.5	69.5	11.3	25.8	37.1
1983	502.8	33.2	66.8	9.4	19.1	28.5
1984	530.4	25.1	74.9	7.1	21.3	28.4
1985	455.6	30.6	69.4	7.3	16.6	23.9
1986	417.1	35.0	65.0	7.0	13.0	20.0
1987	411.3	43.1	56.9	8.3	10.9	19.2
1988	465.8	38.5	61.5	8.0	12.8	20.8
1989	507.9	36.1	63.9	7.6	13.5	21.1
1990	678.3	19.6	80.4	5.1	20.8	25.9

Sources:-

1- Data for column [1]. For the years (1980-1985) from IMF (1986) and (1991a) (International Financial Statistics). For the years (1986-1990) from IMF (1993) (International Financial Statistics).

2- Column [2]. Calculated by the researcher employing the data of Government GFCF in the IMF (1991a) (Government Statistics Yearbook) for the years (1980-1985), and IMF (1992) (Government Statistics Yearbook) for the years (1986-1990).

3- Column [3]= 100%- figures in column [2].

4- Columns [4] [5] and [6] are calculated by the researcher employing the GDP data in Central Bank of Jordan (1989) and (1992).

Thus, the role of the government in regulating the economy has a more vital impact because the institutional context of the state is reflected in its regulatory role⁶.

Although the government in Jordan pursues free market policies, decisions are made on imports (who? what? how much?) through centralized units. The government also determines the domestic prices at which goods can be imported or exported. In other words, it uses licensing as an effective means of favouring and rewarding special interest groups. Moreover, the government indirectly decides who obtains bank credits because most financing is based on collateral rather than on risk assessment (Ghezawi, et al., 1989, p.19). In other words, the rich can get access to loans, especially in the specialist financial institutions.

Other protectionist policies, such as the competition with imported goods and the use of overvalued exchange rates (until 1988) are also decided by central government.

The concept of rent-seeking applied well to the government regulatory structure. The spending of resources to establish, acquire or maintain a government-granted monopoly or secure an otherwise privileged position is widespread.

In this context, the effect of government regulation is more excessive than the figures shown by the government

⁶For more detailed analysis, see the discussion of the New Institutional Economics (NIE) literature in the first chapter.

spending ratio. The problem with this role however, is that it cannot be quantified or measured, although its effect could well be assessed by employing the institutional approach .

The Jordanian state is a mercantile state. In a mercantile state, consumers are not allowed to decide what should be produced, in the sense of demand and supply, instead the state reserves to itself the right to single out and promote certain economic activities. In Jordan the Ministry of Industry and Trade, and the Ministry of Supply, were the major players in deciding who and what was to be supplied and consumed in the market (Sullivan, 1987, pp.136-137).

De Soto (1989) contended that there are major differences between a market economy and a mercantile economy.

Competition prevails in the first while privileges and the employment of the law to one's own advantage is a feature of the latter as regulation is the determinant factor of the economy.

Under the standard perfect competition model, selfish behaviour by small independent economic players, such as utility maximization by consumers and profit and wealth maximization by producers, results in a situation which is also desirable in the sense that the value of output, at prevailing market prices, cannot be increased and which is, moreover, pareto optimal. However as Buchanan (1980,

p.4) argued, once the institutional framework moves away from that associated with perfect competition, "institutions have moved away from ordered markets toward the near chaos of direct political allocation ", DUP activities will arise.

The second difference is that market economies tend to serve consumers efficiently, while in mercantilism, bureaucrats serve at the cost of society.

The third difference is that entrepreneurs in market economies tend to satisfy customer requirements of quality, price and sustainable supply while in a mercantile society entrepreneurs seek to satisfy the state so as to win privileges through its policies. Thus corruption is often a feature of a mercantile state and this is the case in Jordan (Financial Times, 29th June 1989, p.4). Furthermore, corruption throughout different Jordanian administrations is precisely Jordan's major illness as parliamentary debates reveal (Susser, 1992, p.462).

Another difference is that in a mercantile economy, entrepreneurs and workers spend an increasing amount of time complaining, flattering and negotiating. In this case competition for the profits connected with political influence become the concern of entrepreneurs. The aim is to obtain economic monopoly positions as the political sphere becomes subordinated to economic self interest. The consequences are that resources are spent obtaining a larger share of a given stake rather than one increasing

the size of the stake itself.

Moreover, government, as in the case of Jordan, has to employ more bureaucrats in order to meet the demands of the special interest groups. In Jordan 48 percent of the work force is employed by the government, mainly in its services sector. Such bureaucrats are not the same as genuine workers. They increase neither production nor investments by their efforts. However, they do increase the complexity of state regulation by their daily intervention in the economic life of small producers and the general population.

The most decisive difference, which can be used to criticize those who believe in enhancing individual choice and freedom through privatizing public ownership, is that in Jordan access to the market is restricted. This means that the problem lies with the complexity of regulation. Special licences are required for almost everything (Sullivan, 1987). This creates a constant need for assistance from privileged private groups or authorities who control or guard the administrative gates. Thus rent seeking becomes the norm, while large numbers of working papers are needed to gain access to markets.

In summary the attributes of the state regulatory role in Jordan are: centralization of economic decision making within a small elite; special interest legislation; the non-existence of or only very weak public accountability,

and the non- involvement of basic local institutions or smaller business groups (as the small producers) in the economic process. Its features also include favouritism rather than efficiency and the promotion of monopoly powers.

Thus, it can be concluded that the regulatory role of the state in Jordan is more important in its effect than government spending because it restricts the market and the initiatives of ordinary private entrepreneurs who lack access to the decision making body.

Thus, laws encouraging private investment have not succeeded in attracting domestic entrepreneurs to invest in the manufacturing sector; rather entrepreneurs have directed their investment towards construction, particularly of housing, and to the services sector where there are lower risks and a shorter time span for investment.

6.2.3: Government Ownership

In the case of Jordan, there was no nationalization or a centralized planned economy, as was the case in the majority of developing countries, particularly after their independence. This is because of the ideological belief of the state in the market-oriented policies and the effectiveness of the free-enterprise model as a path for development. However, according to the Jordanian Ministry of Planning's five year plan for 1986-1990, the state,

although it has carried out indicative planning, pursues a laissez-faire approach based on individual initiative and adjustment to market demand and supply.

Historically, government ownership in Jordan passed through three different phases.

The first was between 1921 and 1951 when there was neither the place for government ownership nor the funds to build the economy. The state's main priority was to establish its authority and legitimacy while responding to private sector demands by means of regulation; an example was the relinquishing of income tax declarations.

The second phase was between 1952 and 1972 when the private sector was the leader, initiator and main engine of investment. The only exception was the establishment of a state cement industry in 1951 because the size of the investment was beyond the financial capabilities of the private sector. Thus, a joint venture, in which the state owned 51 percent of the cement industry, was the first form of government ownership. In other cases the government participated with fewer than the majority shares and in order to overcome the shortages of funds in private projects. Given the relatively limited external and internal sources for financing the government budget at the time and the limited demand in the economy, the allocative role of the state was simply restricted to "helping" the private sector (Sha'sha, 1991).

In 1973 the role of the state started its third phase as

an owner of major projects. Two factors were mainly responsible for this phase, which is the more relevant for the privatization discourse. The first was the increase in government revenues which created a new and immense capacity for the government to intervene through the means of production. The second was the need to build services, an infrastructure and a modern industrial base in a country lacking many of the natural resources owned by its neighbours. As a result, the Jordanian state participates directly in the production sector for three reasons. The first is the substantial capital required for capital-intensive projects, particularly in mineral projects which the private sector cannot afford. The second is the high risk surrounding investment in some projects and the final reason is related to the two above, namely control of the commanding height industries, which the state is keen to be involved in, in order to generate revenue and foreign exchange (i.e., mineral based industry) (Kanovsky, 1990, p.338). The small size of the Jordanian market will naturally lead one to the conclusion that most government participation in ownership implies a high probability of a monopolistic position and indeed this is often the case. The share of value added generated by the central government (pure state sector) during the period 1970-1992 averaged 21.5 percent⁷. This includes all government services such as defence, public administration,

⁷Calculated by the researcher employing the data in Central Bank of Jordan (1989, Table no.47) and Central Bank of Jordan, 1992, Table no.46) and EIU (1993, p.15).

education, health, etc. Thus, it is obvious that the state sectoral contribution is highly limited. On the public sector level it was estimated that in mid-1986 it produced about 40 percent of the country's GNP, possessed nearly 50 percent of capital formation and employed nearly half the country's work force [(Fank (1986) as cited in Brand (1992, p.170)].

6.2.3.1: Notions of State-Owned Enterprises (SOEs)

According to IMF statistics, there were 19 non financial SOEs in Jordan in 1987 (as table 6.5 depicts). This is the same as in 1993. However, there are three kinds of SOEs.

Table 6.5

Non-financial State-Owned Enterprises in Jordan in 1987

	Non-financial SOEs		Non-financial SOEs
1	Aqaba Railway Corp	11	Water Authority
2	Civil Aviation Authority	12	Jordan Electricity Authority
3	Civil employees Consumption Corp.	13	Jordan Hijaz Railway
4	Free Zones Corp.	14	Jordan Hotels and Tourism Co.
5	General Transportation Corp.	15	Ports Corp.
6	Himmeh Hot springs Co.	16	Jordan Phosphate Mines Co. and Subsidiary: Jordan Fertilizer Co.
7	Holy Lands Hotel Corp.	17	Royal Jordanian Airlines
8	Hotels Corp.	18	Posts and Telecommunication
9	Housing Corp.	19	Jordan Cement Co.
10	Jordan Broadcasting & Television	20	

Source:IMF (1987, p.67).

a. Pure state sector departments: Some such departments are involved in commercial activities and are fully owned by the central government. Their funding is derived from the government budget and they are staffed by civil servants. Examples are the Civil Employees Consumption Corp. and the Free Zones Corp. Their relative importance derives from the spending power of the central government. In the five-year development plan (1981-1985) 27 percent of the resources allocated for development expenditure were to be used by the pure state sector departments or what are called central government departments.

b. Autonomous State Institutions: These institutions arise through a gradual transformation of government departments or similar administrative structures. They are owned by government but are at the same time legally, financially and administratively independent. In spite of this apparent autonomy the board is generally appointed by the cabinet and central government continues to exercise administrative and financial control. Examples are the Public Transportation Corp, the Water Authority, Jordan Electricity Authority and Royal Jordanian Airlines. Their share of development expenditure was estimated to be 34 percent of the total allocated in the 1981-1985 development plan*.

*The figures for the share of development expenditure in both pure and autonomous SOEs are adopted from Brand (1992, p.170).

c. Mixed Enterprises: These are share holding companies in which the central government or autonomous state institutions have equity participation. Government representation on the board of directors in such enterprises is linked to its share in the company's paid up capital. Their total number in 1985 was about 90. Examples are the Arab Potash Company (the largest in Jordan with a government share of 53 per cent) and the Jordan Phosphate Mines Company (government share 69 per cent) (Khalaf, 1989, pp.236-237)

6.2.3.2: The Role of SOEs on the Sectoral Level

The domination of SOEs can be divided among the economic sectors into three levels.

6.2.3.2.1: Pure Domination

There are three activities where the government operates as a monopolist; the water sector, which is the domain of an autonomous public institution (The Water Authority); telecommunication activity is represented by the Telecommunication Corporation, which operates as an integral part of the central government; and finally electricity generation through Jordan Electricity Authority accounted for 92 percent of the total electricity output in 1992. The remainder of electricity is generated by the industrial companies [e.g., The Jordan Cement factories, the Jordan Phosphates Mines Company (JPMC), and the fertilizer companies] for their own use

only (calculated by the researcher employing the data in Jordan Electricity Authority, 1993, Table no.5, p.21).

6.2.3.2.2: Equity Sharing

There are two important economic sectors where the government possess an equity sharing.

a. Mining: In this sector, the state holds its largest share. The country is the world's fifth biggest producer of phosphates rock and the third biggest exporter after Morocco and the U.S.A. The government possesses 38.4 percent of the equity of the Phosphates Mines Company, and in potash it holds 53 percent of The Arab Potash Company. Total state investment amounts to about 50 percent of the capital of mining companies and represents almost 1/2 of the total state shareholding in all Jordanian corporations (Anani and Khalaf, 1989, p.216).

b. Manufacturing: The total equity share of government in this sector amounts to about 23.2 percent of the whole capital of the manufacturing shareholding companies in Jordan.

The state's participation ranges from 0.02 percent in the Arab Aluminium Industry to 49.7 percent in the Jordan Glass Industries. In actual terms, 87 percent of state equity sharing in this sector is held in the four largest companies: the Jordan Cement Factories, the Jordanian Petroleum Refinery, the Glass Industries and the

Engineering Industries. The share of capital in these four companies represents 56 per cent of all the capital of the 48 manufacturing companies in Jordan (ibid).

6.2.3.2.3: Mixed Sectors

There are two mixed activities where the state operates to some extent with the private sector.

The first is transportation where the state contributed about 2/3 of the value added during 1970-1988. However, the only competition between the private sector and the state is in land transportation. Air transportation is a monopoly, and rail transportation (Aqaba Railway and the Hijaz Railway) is an oligopoly. The ports are run by an autonomous state institution (The ports Authority) (Khalaf, 1989, pp. 240-241)

The second is electricity distribution. In this activity there are two share holding companies (the Jordan Electricity Company and Irbid Electricity Company) which distributed 58 percent of the electricity power generated by Jordan electricity authority in 1992 (47 percent and 11 percent respectively) (calculated by the researcher employing the data in Jordan Electricity Authority, 1993, table no.12, p.27). However, the state possesses shares in both of them (13.6 percent and 55 percent respectively) and they are regulated by the government.

In summary, it can be said that the absolute private sector can be found operating in agriculture and quarrying while the Jordanian state possesses a limited allocative effectiveness through direct ownership and production. In that, it does appear to be on the same side as the advocates of the market approach.

However, the idea of privatization in Jordan started to appear on the government agenda during the mid-1980s.

6.3: Objectives and Reasons for Privatization of SOEs

The thinking of privatization as a new economic policy in Jordan was initiated in 1985 after a new government took office in April. The new P.M. (Al-Rafai) was himself one of the major advocates of reform policies in Jordan. Privatization was part of a larger reform package for the economy⁹. However, the idea of privatization was announced in a paper entitled "The role of the private sector in development" which was presented to the Jordan Development Conference from 8 to 10 November 1986. The main goal of the conference was a review of the 1986-1990 five-year plan. The government established a special permanent privatization committee at ministerial level to study the most suitable techniques for implementing the proposed privatization policies.

The objectives set out in the paper provide a clear view of the government's objectives and privatization measures.

⁹For a review of Jordan's reforms record (1985-1989) see Brand (1992, pp.173-179).

The policies stated in the paper were:

"First, promoting the private sector in its traditional domain through the following measures:

1. Minimizing market distortions by allowing market forces to determine the prices of factors of production as well as the price of final output of industries.
2. Providing support for research to enhance the efficiency of private sector operations and to have pre-feasibility studies made available to private investors at a minimal cost.
3. Devising policies and incentives to encourage private investors.
4. Pledging consistent and uniform application of government policies to reduce disparities in the treatment of foreign and domestic firms.
5. Providing a supportive legal environment to the property rights and contractual obligations and having a commercial law for the settlement of disputes.

Second, transferring public control of PEs to the private sector. This strategy envisages the following measures;

1. Sale of state-owned shares in mixed enterprises to the private sector.
2. Transferring ownership of autonomous PEs to the private sector.
3. Authorizing the establishment of private universities.
4. Leasing state-owned agriculture land to the private sector." (quoted from Al-Quaryoty, 1989, p.170).

From this, it seems that privatization in Jordan does not reflect any shift in economic or political ideologies and one must therefore ask why privatization was initiated at this time.

a. Economic Recession

When the institutional factors were introduced in the last chapter, it was shown that the recession in the economies of the rich oil Gulf states after the decline in oil prices had an immense effect on Jordan. Thus, when the price of oil declined sharply in 1986, government external revenues declined from 350.2 MJDS in 1985 to 303 MJDS and 190 MJDS in 1986 and 1987 respectively (Central Bank of

Jordan, 1989, pp.45-46). This was combined with a sharp decline in workers' remittances from 414 MJDs in 1986 to 317.7 MJDs in 1987 (ibid, pp. 26-29). GDP real growth rates started a decline from 9 percent in 1986 to only 2.8 percent in 1987 and entered negative growth during 1988-1990 (calculated from IMF, 1991, p.346 and 1992, p.318). There were many ideas for reducing the role of the state and giving the private sector the first initiative on the basis, though without solid evidence, that the Jordanian private sector would be far more efficient than the state sector.

b. Growing Budgetary Deficit

Another major reason for considering privatization was the Jordanian central government's growing budgetary deficit. Table (6.6) shows that the deficit rose more than twofold from 109.9 MJDs in 1980 to 247.8 MJDs in 1987. In other words, the government thought that the sale of SOEs would enhance its financial position and reduce the budgetary deficit. According to UNDP this is one of the seven sins of privatization because "selling assets to meet current liabilities is mortgaging the options of future generations" (UNDP, 1993, p.50).

c. The Debt Crisis

The debt crisis has had an immense impact upon Jordan's economy. During the period 1984-1987 external debt rose sharply from \$3508 million to \$8641 million .

Table 6.6

Overall Deficit in the Jordanian Central Government Budget (1980-1990)

Year	Deficit (MJDS)
1980	109.9
1981	115.9
1982	128.2
1983	108.5
1984	139.7
1985	153.1
1986	130.0
1987	247.8
1988	208.3
1989	137.5
1990	92.1
1991*	12.4
1992*	144.2

Sources:-

1-Data for 1980-1989 from the IMF (1991a, p.345).

2-Data for 1990 from IMF (1992a, p.318).

3-Data for 1991 and 1992 from (EIU, 1993, p.29).

*Preliminary.

Consequently, Jordan started approaching the eurodollar financial markets and other international aid agencies to acquire more financial support in the second half of the 1980s.

A privatization plan was essential for the government in approaching the IMF, and the World Bank in particular, because it dressed the government in a reformist outfit and matched the demands of the international agencies (Dessouki and Aboul Kheir, 1991, p.221). As a result the government secured credits worth \$262 million from the IMF during the period 1985-1988, and \$107 million worth of loans from the World Bank in 1987/1988¹⁰. Part of the World Bank's loans was allocated to cover the consultancy service costs required to study the feasibility of privatizing the Telecommunication Corporation (TCC).

D. Attracting Foreign Investment

Another reason for seeing privatization as a viable solution to the economic problems in Jordan was the need to increase the flow of foreign investment to the country. As table (6.4) shows, there was a real need to substitute the shortages of investment in the country. While in 1981 the investment ratio (total investment to the GDP) was about 39 percent, it declined to only around 20 percent in 1986. Although historically Jordan was not an attractive destination for private investment, as table (6.7)

¹⁰The figure of \$262 million was distributed between \$63 mn, \$70 mn, \$81 mn, and \$48 mn during 1985, 1986, 1987 and 1988 respectively (EIU, 1992c, p.35).

depicts, the declining share of investment in the GDP forced the Jordanian decision makers to rethink their policies, particularly as there was little prospect of increasing Arab aid.

Table 6.7

Net Private Foreign Investment in Jordan,
1979-1989 (Selected Years)

Years	Net private foreign investment \$ million	Years	Net private foreign investment \$ million
1979	26	1986	21
1981	143	1987	33
1983	30	1988	0
1984	71	1989	0
1985	23		

Source: World Bank Reports (various years) as cited in Joffe (1993, table no.7.1, p.134).

Privatization in the context of deregulation and new incentives for foreign ownership were ways of increasing investment in the country as well as the efficiency of that investment because foreign investors will not invest their capital in unviable projects.

For example, the idea of privatizing Royal Jordanian Airlines (RJ) originated from the need for new investment to replace its aging fleet of aircraft and expand its services to new destinations. In the case of the telecommunication corporation (TCC) about 70 percent of the investment projects with estimated costs of 91 MJDS during 1986-1990 had to be financed by hard currency particularly as the bulk of the technical equipment for

the projects needed to be imported. In addition, reliance on foreign consultants as technical staff imposed further constraints on the financial capacity of the corporation. Similar arguments can be found in the purchase of new buses for the Public Transport Corp. (PTC) in Amman (Ministry of Planning, 1986, pp.421-465). It was believed that higher foreign investment and greater efficiency of the economy would be essential ingredients for the achievement of respectable GDP growth.

Given the marginal role of foreign investment in Jordan, the other benefit from the liberalization policies, of which privatization constitutes but one cornerstone, is "to show some concurrence with the perceptions of the IMF and the World Bank" on the openness for such investment (Joffe, 1993, p.139).

E. The Imitation Factor

Another reason is the imitation of the Western idea of privatization, particularly that of the new-conservatives in the U.S.A. and Britain. Since most of the government is composed of professionals educated in those two countries, any new academic or western image has been emulated to give the country a modern face. The preference for foreign experts, foreign models, and foreign standards is a consequence of Jordan's imitative modernism. However, this over-academic image is even found in the reactions of the country's top decision makers (Guardian, 28th April 1989, p.15).

From the preceding analysis there is little doubt that there was no deep-seated commitment on the part of Jordan's decision makers to follow the path of privatization, but there were several factors which limited the government's freedom to continue the management of the economy as they had done before the economic crisis in the mid-1980s. The recession and the pressure from international financial institutions to cut public expenditure, the lack of investment funds as well as the modernity image of the country in an integrated international environment all played a significant role in the consideration of privatization proposals.

6.4: Performance of State-Owned Enterprises (SOEs)

6.4.1: The Economic Performance

6.4.1.1: The General Economic Performance

In the case of Jordan there are no comparative studies of the economic performance of public versus private sector enterprises. This is because of the difficulty of finding like-with-like efficiency comparisons between different enterprises. This stems from the advantages of economies of scale in a small market. These provide most public enterprises in Jordan with the basis for a monopolistic position. However, three commentators have referred to the comparative efficiency between public and private ownership in Jordan.

In general terms Robins (1986, p.52) argued that the rate of return on public investment is roughly half the rate achieved by the private sector. However, this conclusion was not based on any conclusive evidence or methodological empirical studies.

A second study by two senior Jordanian economists, Anani and Khalaf (1989) stated that;

" Although there is a complaint that government-owned enterprises are not as efficiently run as those in the private sector, there is no clear-cut empirical evidence to support such a statement in the case of Jordan. While there are clear indications that testify to better management in privately owned and managed organizations, evidence to the contrary is also available" (p.212).

However, the study also pointed out that an inadequate rate of return could be found in government shares in the share holding companies. It was found that where the opportunity cost of maintaining such shares exceeded 7 percent the rate of return, on average, was less than 3 percent (ibid, p.212).

Al-Quaryoty (1989, p.177) argued that the efficiency of the Jordan Electric Company, which is a private franchise, is not much better than that of the Jordan Electricity Authority which is a state enterprise. The researcher thus dismisses the option of franchising SOEs in Jordan because of the limited number of potential contractors willing and able to provide such services.

6.4.1.2: Case Study: Jordan Electricity Authority (JEA)

In order to investigate the economic performance of SOEs in Jordan Table (6.8) depicts the performance indicators of one Jordanian state enterprise, that is Jordan Electricity Authority (JEA) during the period 1987-1992. This enterprise produced more than 91 percent of the total electricity generated in the Kingdom during the period 1987-1992.

Table (6.8) indicates that there was an increasing trend in employee productivity during the period 1990-1992. Nevertheless, the figure for 1992 (1973 M.W.H/employee) reflects the increase in production for export (to Syria) which constituted 1.7 percent of the total electricity generated by JEA in 1992. This in itself represented a new way of utilizing the JEA's capacity. The increase in employee productivity in 1992 was 20.2 percent in comparison with 1991.

In terms of technical efficiency, the indicator for the thermal efficiency of generation stations revealed a slight decline in 1992 when compared with 1991. Nevertheless, in comparison with the total sector in the Kingdom, the efficiency of JEA was 0.3 percent higher (calculated by the researcher employing JEA, 1993, p.16). Another important measure of quality for the services provided by the JEA is the average time without electricity by consumers in the Kingdom. Apart from 1992, in which snow storms affected the provision of services, there was an increasing trend in the quality of services

Table 6.8

Performance Indicators of Jordan Electricity
Authority During the Period (1987-1992)

Years ----- indicators	1987	1988	1989	1990	1991	1992
<u>Workforce indicators</u>						
1-Annual productivity (M.W.H/employee)	1730a	1530	1627	1623	1641	1973a
2-Generating capacity (M.W/employee)	0.5	0.5	0.5	0.46	0.46	0.46
3-Number of customers (customer/employee)	103	107	107	109	112	112
<u>Technical indicators</u>						
1-Thermal efficiency for generation stations(%)	33.5	33.8	34.6	34.3	33.8	33.3
2-Average cut in power for consumers(hour/year)	8.4	6.8	7.0	6.0	5.5	17.0
3.Total Percentage of electricity loss(%)	10.1	10.2	10.1	10.3	10.2	9.9
<u>Rate of return on fixed assets</u>	4.4	3.2	-1.8	6.4	4.04	5.99

Source: Jordan Electricity Authority (1993, table no.1, p.17.

a. In 1987 and 1992 the figure includes electricity exports.

M.W.H: Mega Watt per Hour.

M.W: Mega Watt.

provided by the corporation. The average time without electricity supply declined from 7.9 hours/year in 1987 to only 5.5 hours/year in 1991.

The percentage loss in electricity, which is one of the technical features in the electricity industry, was much less than for that in the whole sector. While it was 15.4 percent for the latter, it was only 9.9 percent in the JEA (JEA, 1993, p.16).

The indicator of the rate of return on fixed assets shows a positive trend. The nearly two percent increase in the rate of return, from 4 to 6 percent, between 1991 and 1992, according to JEA reports, was the result of hard budget policy and strict monitoring of corporation expenditures, particularly of investment in new projects. This reduced the opportunistic behaviour of the corporation's employees which reduced the agency costs. This is consistent with Vickers and Yarrow's (1991) argument regarding the positive effect of tightened state budgets on limiting managerial discretion and increasing efficiency.

The above figures suggest that the economic efficiency of the JEA was better in comparison with the indicators of the total electricity sector. Furthermore, there is evidence that the quality of the services reached higher standards during the period 1987-1991. In addition, there was a positive rate of return on the JEA's fixed assets.

From the studies above as well as the case study of the JEA, there is no clear-cut evidence of superior economic performance within the private sector in Jordan as opposed to the state owned sector, or that SOEs are necessarily linked with economic inefficiency. This is consistent with the empirical evidence provided in chapter 3 on the comparative efficiency of public versus private ownership in developing countries.

6.4.2: The Financial Performance

One of the problems facing Jordanian SOEs is the low profitability if not the large losses incurred by them. The reasons for such poor financial performance vary from one enterprise to another and in any case, economically efficient does not necessarily mean financially profitable, especially in decreasing cost industries¹¹. However, other factors such as equity considerations also play a major role in determining the profitability of a state enterprise.

6.4.2.1: Case Study: Jordan Electricity Authority (JEA)

Despite a trend of increasing productivity and a positive rate of return on fixed assets JEA suffered large losses between 1987 and 1991, particularly during 1989 and 1990 (19.1 MJDS and 14.5 MJDS respectively). As table (6.9) depicts, the problem of profitability lies mainly with

¹¹For further analysis of this subject review chapter 2.

Table 6.9

The Financial Performance of Jordan Electricity
 Authority for the Years (1987-1992)
 (Thousand JDs)

Years ----- Indicators	1987	1988	1989	1990	1991	1992
1. Electricity sale net profits.	(88)	(3637)	(19161)	(14514)	(7525)	2415
2. Unit cost (F. per K.W.H)*.	20.74	22.98	27.76	27.23	27.38	24.38
3. Unit revenue (F. Per K.W.H).	20.7	22.02	21.02	22.28	24.87	25.05
4. Net profit per unit sold (F. per K.W.H).	(0.07)	(0.96)	(6.74)	(4.97)	(2.51)	0.67
5. Annual capital investment	11760	27452	12658	2454	8826	4820
6. External contents of (5)(%)	100	68	55	14.3	9.5	10.0
7. Net working capital	3974	(18894)	(26697)	(33527)	(35830)	(37640)
8. Debt payment and service as % of total revenue	41	54.4	57.4	89.7	70.2	43.1
9. Self finance (%)	15	(-)	(-)	(-)	(-)	(-)

Sources:-

1- Indicators no. 2,3,5 and 9 adopted from JEA (1993, p.52)

2- Indicators 1,4,6,7, and 8 calculated by the researcher employing the data in (JEA, 1993, p.52).

*Unit cost measurement in Fils per Kilo Watt Hour.

Each 1 JD equals to 1000 Fils.

three factors. The first is the government pricing policy towards public electricity supplies. This imposed a tariff rate on the corporation which did not reflect the marginal costs of the electricity unit supplied to the customer and resulted in losses from the sale of each unit of electricity at the rate of -0.04, -0.96, -6.74, -4.97 and -2.51 fils during 1987-1991.

The second factor relates to investment. Many of the proposed projects required a high proportion of external finance. The policy of external borrowing to finance some questionable projects, such as the unification of electricity grids with neighbouring Arab states, led to a long-term debt burden which affected the profitability of the JEA. The debt payment and its services constituted about 60 percent of the total revenue generated from electricity sales during the 6 year-period of study. Also, the outturn costs of foreign borrowing crucially depended upon movement in relative exchange rates shaped by factors completely outside the control of JEA. For example a major conflict between the Finance Ministry and the JEA arose over the rouble exchange rate required for the repayment of a Russian loan to the JEA. While the Ministry insisted upon an exchange rate of \$1.65 for the rouble, the JEA said that the rate should be equal to the one at the date of borrowing.

Following the same argument, the devaluation of the Jordanian dinar in 1988 and 1989 imposed heavy losses on the Authority during 1989 and 1990. As a result, the net

working capital of the JEA has been negative since 1988, which reflects the inability of the enterprise to finance any proportion of its projects.

The last factor, which is related to the previous two, is the management of the enterprise. The policy of increasing accountability and responsibility in 1992 bore fruit by converting 7.5 MJDS losses from 1991 into 2.4 MJDS profits in 1992. Imposing restrictions on current expenditure and the proportion of foreign currency required for investment were among the major factors behind the success. For example, management lowered the amount of external finance from 18.8 MJDS in 1988 to less than 0.5 MJDS in 1992.

In summary, the financial performance of JEA during the period 1987-1991 was poor because of a number of factors which were not found to be exclusive to its ownership. The debt and investment problems are part of the structural problems mainly due to the poor management of the economy as a whole rather than a result of the geometry of ownership.

As Satloff (1992) argued, Jordanian decision makers after feeling the crisis in the economy during the mid-1980s, chose not to respond with a tight fiscal policy but instead with one of three options:

"to ignore the glaring structural weakness in the economy, to hide them under the rug of further borrowing at commercial rates, or to exacerbate them with expansionary policies that only shrank the Kingdom's finite foreign currency reserves" (1992, p.132).

Such options can go some way towards explaining the deterioration in the financial performance of JEA during the period 1987-1990.

6.4.2.2 :The General Financial Performance of SOEs

According to the available data the financial performance of many SOEs seems to be poor. Table (6.10) depicts the external debt of the non-financial SOEs in Jordan at around \$1517.2 million (about 871.8 MJDS) in 1989. This debt constituted 34.3 percent of the country's GDP. In 1990, however, there was an estimated decline in the external debt for these enterprises of \$194.5 million, which is a much healthier sign in comparison with previous years. The external debt began its increase in 1970. After being \$5.0 million in 1970, it reached \$430.0 million in 1980.

This reflects the poor overall management of the economy, particularly in depending on external sources of finance, and the poor financial performance of Jordanian SOEs. As long as loans, foreign aid and grants are able to maximize government revenues and minimize its transaction costs, particularly monitoring costs, the government relied on them rather than on reforming its monitoring system. Another remarkable phenomenon of SOEs is the poor financial performance of the public shareholding companies in which government participates through its paid capital. In 1985, about 22 percent of the 90 shareholding companies

Table 6.10

Jordanian Non-financial SOEs External Debt
(1970-1990) (\$ million)

Year	External debt	Year	External debt
1970	5.0	1981	705.8
1971	21.2	1982	906.3
1972	21.2	1983	891.7
1973	21.4	1984	976.4
1974	43.8	1985	1060.1
1975	61.1	1986	1220.5
1976	61.8	1987	1423.1
1977	167.9	1988	1345.2
1978	227.0	1989	1517.2
1979	299.2	1990	1322.7
1980	430.0	1991	n.a

Sources: World Bank (1991) and (1992).

suffered losses, more than 60 percent of them in the industrial or mining activities [calculated from Brand (1992, p.171)].

More recent figures for the financial return on government investment in shareholding companies are presented in table (6.11).

State investment is mainly directed through the Jordan Investment Corporation (JIC) which was established in 1988 as a substitute for the Pension Fund. From the table it is clear that the rate of return fluctuated sharply between 1989 and 1990 because of the Gulf War. However, even in 1991, only 16 out of 36 companies in the Industrial and Mining sectors produced profits while the remaining 20 did

not distribute any profits to their shareholders (Ministry of Finance, 1992, pp.129-130).

Table 6.11

The Financial Returns for the Jordan Investment Corporation (JIC) from Investment in Shareholding Companies During the Period 1989-1991

Year	Number of companies	Value of investment	Total profits	Rate of return
		MJDs	MJDs	(%)
1989	70	150.3	15.89	10.5
1990	70	149.9	3.1	2.1
1991	67	116.1	10.3	8.8

Source: Calculated by the researcher employing the data in Ministry of Finance (1992, pp.127-139).

This is a very serious problem because these companies were set up to operate in an essentially commercial environment. No one could argue that the companies were established with non-commercial objectives, the argument always employed by the state to defend its position in the case of poor performance of its enterprises.

However, there are many reasons for the poor financial performance of both shareholding companies and purely state-owned enterprises. One is that companies whose products are mainly for export, such as the Arab Potash Company (APC) and the Jordan Phosphate Mines Company (JPMC), suffered from unfavourable terms of trade; for example, the declining prices of their products on world

markets during the 1980s. The Arab Potash Company which recorded its first profit of 39.6 MJDs began commercial operations in 1983 (Fisher, 1993, p.568).

Declining prices for phosphates during 1986, 1987 and 1988 brought the unit value of their export prices (1985=100) to 87.4, 76.8 and 92.0 during 1986, 1987 and 1988 respectively (IMF, 1992b, p.316). After the boost in the world phosphate prices in 1989 and the devaluation of the dinar in 1988 and 1989, the Phosphate Mines Company enjoyed profits totalling 107 MJDs and 41.4 MJDs in 1989 and 1990 respectively (Fisher, 1993, p.568). The decline or losses in such companies depend upon international demand and their competitiveness on the world market. Although both are shareholding companies, they are primarily financed through state funding and backed by state sector institutions because they represent an important part of the commanding heights industries in Jordan.

The second reason is the inadequacy of feasibility studies. One example is the South Cement Company which was established on the basis of an inadequate feasibility study conducted in the 1970s. This company faced difficulties in marketing even in its initial levels of output and the result was a merger with the Jordan Cement Factories company in September 1985 (Al-Quaryoty, 1989). Another example is Jordan's Fertilizer Industries Company (JFIC). It was estimated that the cost of the project

would be about \$300 million but actual costs reached \$410 million. In addition, as a result of a slump in world fertilizer prices, JFIC lost about 13 MJDS in 1984, its first year of trading, and in 1986, the JPMC bought the corporation, which by the end of 1985 had accumulated losses of \$40 million, for only 60 MJDS (Fisher, 1986, p.516).

Poor financial performance can also be the result of uncompetitive prices when compared with imported products. The Jordan Glass Industry Company (JGIC) faced a problem in marketing its inefficiently produced glass. Continuous government injection of capital into the company failed to transfer its losses into profits. Government protectionist policies, completely banning the import of white glass, as well as other cost control measures undertaken by the company, only succeeded in cutting losses by a third in 1986 (Brand, 1992, p.171). These two companies (fertilizer and glass) are clear examples of inappropriate government policies of import-substitution industrialization.

Another reason for poor financial performance is the lack of an appropriate incentive and monitoring system. This can be found in the majority of public enterprises in Jordan. The Public Transport Corporation, for example, which carries about 20 percent of public transport passengers in and around greater Amman, faces strong competition from buses and taxicabs in the private sector.

Since its establishment in 1975 it has made an annual loss of 0.5 MJDs (Khalaf, 1989, p.246). Weak institutional management and an ill-functioning incentive and monitoring structure are the main reasons.

In SOEs such as the Electricity Authority, or institutions such as the Water Authority, government pricing at a level below the marginal unit cost of production, has led to planned losses (e.g., table 6.9, indicator 4). This is because of social criteria implicit in government decisions to subsidise such basic goods for the population. Other companies, however, produced poor financial performances because of inefficiency in their operations. It is questionable whether they should ever have been established in the first place.

Corruption in some public enterprises also contributed significantly to their poor financial results. The Department of Public Security spent \$350 million on a communication system which could have been purchased at much lower cost on the world market (Guardian, 28th April 1989, P.15). Another scandal concerned Royal Jordanian Airlines. In 1989, the company was found to have debts amounting to about \$192 million although all of this debt was believed to have been repaid the same year from the sale of its fleet of aircraft. Other cases of corruption can be found throughout the different institutions (Guardian, 25th April 1989, p.14) (Guardian, 21st April 1989, p.10).

Another factor which seems to affect the economy as well as public enterprises is regional political spillover. For example, the Gulf War caused Royal Jordanian Airlines losses estimated to be around \$100 million (Fisher, 1991, p.586). Another example is the effects of U.N. sanctions on Iraq on business in Jordan's Ports Corporation. The cost of U.N. inspections was estimated at \$30 million in 1992 and was expected to go up by 10 percent by the end of 1993 (Arab News, 17th November 1993). Such factors reflect the extent to which regional politics affect the financial performance of some SOEs.

Anani and Khalaf (1989) in their study of privatization in Jordan listed six reasons for the inefficiency of SOEs. In summary the reasons were 1) overstaffing and recruitment policies, particularly in the autonomous state enterprises; 2) government pricing regulations; 3) weak systems of control where they existed; 4) weak incentive systems with some enterprises giving a bonus equal to two months salary every year to every employee; 5) inadequate accounting systems leading to further misallocation of future investments; and 6) the absence of systematic monitoring since government representatives on the board of directors in many shareholding companies are appointed for political rather than technical reasons (ibid, 1989, pp.217-218).

From the previous analyses it appears that the problem in the state owned sector was not exclusively a result of

government ownership per se. That is because most of the companies with government participation, which were formed to operate according to commercial criteria, were performing inefficiently while at the same time there were some SOEs performing as efficiently as the private operators.

Despite poor financial performance and frequent recorded announcements on privatization by different government officials, there is no case of divestiture recorded in the country. The following section provides a record of privatization plans and actions by different public corporations.

6.5: Privatization Progress to Date

Only two of the objectives listed in the development conference paper about privatization presented previously had been implemented by the end of 1993.

The first was the establishment of five private universities and as Whittington (1992, p.10) reported;

"Students are presently accepted on the basis of being able to afford the fees rather than academic ability ,..., therefore the private universities are for those students with wealthy parents".

The second was the leasing of unused State-Owned land at a rent of one Jordanian dinar per dunum in November 1990. This decision should be understood in the context of agricultural output deterioration explained in previous chapter. In the oft quoted words of Fisher (1991); it was

" a crisis-induced move to increase domestic agricultural production , ... [particularly] to increase cereal output, on the basis of guaranteed prices for farmers" (emphasis added Fisher, 1991, p.584).

According to the World Bank there were three enterprises, all in the transport and communication sector, which were initially included in the government's privatization plan (Candoy-Sekse, 1988, p.35). However, no real transfer or divestiture within the context of ownership change from public to private has yet taken place. The main candidates for the initial privatization plan were Royal Jordanian Airlines (RJ), the Public Transport Corporation (PTC), and the Telecommunication Corporation (TCC). However, the purpose of this section is to provide for the first time a record of announcements and comments on privatization by government officials and others until the end of 1993¹².

March 1986: Jordan's Minister of Communication, Muhyi Eddeen Huseini, who is also the chairman of the Wire and Wireless Communication Establishment (WWCE) announced that it had been decided to convert WWCE from a state-owned enterprise into a public shareholding company (Al-Rai, 20th March 1986, p.1).

November 1986: In an interview with Al-Tadamun weekly in London, the PM Zaid Al-Rafai confirmed his government policy of backing the private sector role in the economy

¹²This record has been collected entirely by the researcher from secondary resources.

and the need to deter public sector firms from doing what the private sector could do. On the privatization of public firms, he explained that the government would continue to hold part of the equities; the balance, however, was to be offered for private sector subscription (Al-Rai, 1st November 1986, p.1).

February 1987: the Jordanian Cabinet decided to convert the State-Owned Jordanian Co. for Marketing and Processing of Agricultural Products to a private shareholding where the government would acquire 7 MJDS of the capital (70 percent), the Pension Fund and the Social Security Fund would subscribe 12.5 percent each, while the remaining 5 percent would be acquired by the Agricultural Credit Corp (Al-Rai, 20th February 1987, p.1).

July 1987: The government announced its decision to privatize the Public Transport Corporation (PTC). An inter-departmental committee was also formed to evaluate the market value of the corporation (Khalaf, 1989, p.247).

December 1987: Ali Ghandour the chairman of Royal Jordanian Airlines (RJ) said that RJ had signed a \$165 million deal with a consortium of Arab and foreign banks to sell and lease-back five of its eight Lockheed Tristar jets. Negotiations were in progress for the sale of two other Tristars. Earlier in the year RJ had sold a Boeing 747 to British Caledonian Airways for \$ 64 million. These

moves were made in order to repay debts worth \$305 million. RJ chairman said that in January 1988 the corporation would submit a final report on privatization including the legal aspects. He estimated the preliminary value of RJ to be around 85-87 MJDs (\$259 million- \$269 million). However, he confirmed that under the plan agreed with the government RJ would become a shareholding company with the government holding all the shares (Al-Khaleej, 18th December 1987, p.1).

December 1988: The chairman of RJ said that the state-owned airline was set for partial privatization next year. The airline's 5,000 employees would take 10 percent of the equity and foreign ownership would be limited to 35 percent. The government would not necessarily retain a controlling share. It was also suggested that the company would offer shares to Jordanian frequent fliers and travel agents who sold tickets worth more than 100 thousand JDs (\$200 thousand) in 1988. Ghandour said aircraft sales and leaseback deals had enabled the company to pay off all its debts on aircraft, including \$276 million repaid in 1988 (Al-Rai, 21st December 1988, p.8).

April 1989: Jawad Anani, a former Jordanian Minister of Labour, Trade and Industry said in a lecture, part of a week of Jordanian activities in Abu Dhabi in U.A.E., that the financial crisis in Jordan would push the government to cut public sector jobs, raise tax revenues and

privatize firms. Privatization according to him was a viable solution despite the rising figure of unemployment in the Kingdom (Khaleej Times, 4th April 1989, p.11).

August 1989: King Hussain of Jordan removed the chairman of RJ, Ali Ghandour, due to the discovery of fraud and embezzlement in the company after a financial scandal in Jordan's second largest commercial bank, Petra Bank, which affected more than 37 companies in Jordan. The new management under the chairman Abu Ghazaleh started to sell most of RJ's fleet of aircraft, cut some of its unprofitable routes, and imposed a recruitment freeze to repay a debt of \$192 million (EIU, 1992b, p.26)(Fisher, 1991, pp. 579-580).

September 1991: In an interview with Interavia, an air transport Journal, Abu Ghazaleh, chairman of RJ, said that as a result of the Gulf War the corporation had started a "slimming down strategy" in which it had reduced its staff by 400 people, or 6 percent, which allowed it to save from 13-15 percent on salaries particularly through " the reduction in higher-salaried overseas staff". RJ is still committed to privatization and the process is well on the way according to Ghassam Ali, executive vice-president of corporate planning. There is also a plan to sell up to 49 percent of shares to interests outside Jordan (Endres, 1991, p.29).

September 1991: The Jordan Telecommunication Corporation (TCC) started to revive its plans for expansion after their cancellation in 1989 as part of government measures to cut public expenditure by encouraging local and foreign private sector involvement on a build-operate basis. This move was seen by observers as the first concrete form of the government's privatization plan. The new scheme encouraged potential investors to plan, finance, build, operate and maintain projects on a shared revenue basis. The TCC identified the governorates of Ma'raq and Ma'an as the most suitable for the implementation because their existing networks and facilities required almost total replacement (MEED, 20th September 1991, p.15).

September 1991: The Jordan Investment Corporation (JIC), the government-owned establishment responsible for supporting investment in new projects, announced its intention to sell its shares in hotels, newspapers (15 percent in Al-Rai and 15 percent in Al-Dustour dailies) and a number of hotel projects. Its total equity holdings in hotels was valued at between 8 MJDs and 8.5 MJDs (\$11.8 million-\$12.6 million). The move was described by the JIC's Acting General Manager as a way to concentrate efforts to help new projects rather than hold the shares of well established ones (MEED, 20th September 1991, p.16).

August 1992: On August 3rd, a government official in Amman

said that the Council of Ministers had endorsed the principle of transforming the Royal Jordanian corporation into a public corporation whose shares were fully owned by the government and to run it on a commercial basis as a first step towards its privatization. In the last two weeks of July a government committee evaluating RJ's assets and liabilities met twice. The committee was also responsible for preparing the new company's founding charter bylaws and defining its capital before its registration as a public company. The external British auditor (Arthur Anderson) advised the Jordanian government to increase RJ's capital from \$20 million to \$100 million in order to attract foreign interest in the corporation (Arab Times, 4/8/1992, p.17)(MEED, 14th August 1992, p.19).

March 1993: The committee set to supervise the structural overhaul of RJ opted for full privatization rather than a limited form of commercialization for the corporation. The Deputy Prime Minister and Transport Minister, who is the committee chairman, revealed that eight British consultancy firms had been invited to bid to pilot the privatization process. The task of the winner will be to evaluate RJ and to provide technical assistance for the privatization programme. The debt service for the company is now estimated to be around \$40 million a year (MEED, 2nd April 1993, p.29).

July 1993: The Jordanian Telecommunication Corporation (TCC) announced a planned investment of \$300 million during its five-year plan 1993-1997. The finance has World Bank approval. The TCC director-general said that the basic policy would be for TCC to be responsible for the provision of the basic telephone network throughout the country; all other services would be the task of the private sector. Local companies contended that the main problem with this approach to privatization was the regulation of services and the price mechanism employed and regulated by the TCC. They (local companies) expressed their doubts about the TCC's ability to succeed in such a big task (MEED, 23rd July 1993, p.15).

November 1993: On November 16th, the Director General of Jordan Ports corporation revealed a preliminary plan to privatize the state-owned corporation. In this plan the private sector would be given investment opportunities in Aqaba in 1994 because the government does not want to keep full control over port activities in the future. He pointed out that an export port would be constructed and managed by the private sector and as a first step the private sector could share the port management with the government (Arab News, 17th November 1993).

December 1993: It was announced in Amman that the Royal Jordanian airlines were likely to start a privatization programme in April 1994. The RJ signed a contract with a

British company (Peat Management Consultants) to conduct a detailed study of the financial and managerial position of the corporation and to evaluate its assets and liabilities as a first step toward privatization. It was also revealed that RJ had a heavy external and internal debt of \$270 million at the end of 1992. About 40 percent of the debt (\$108 million) was held by local companies (i.e., Jordan Petroleum Refinery and Social Security Corporation), while 60 percent (\$162 million) was with foreign institutions and corporations (Arab News, 9th December 1993).

The above record reveals that the implementation stage of privatization, although a required commitment from the government, should not be rushed into until every aspect of the divestiture mechanism has been looked at.

6.6: Obstacles to Privatization

Two sets of factors delayed the implementation of the privatization programme in Jordan; the first are economic factors and the second non-economic and influenced by the notion of state-society relationship.

6.6.1: The Economic Factors

Many economic factors contributed to the delay of the Jordanian privatization programme.

6.6.1.1: The Valuation of the Enterprise

One of the key problems for the privatization of Jordanian enterprises is the time and resources needed for the valuation of enterprise assets, liabilities, and market value. Taking the Jordanian national airline (RJ) as an example we can observe that from 1986 more than three committees were formed in order to set an accurate valuation of the airline assets and liabilities. As the corporation records reveal, many foreign, as well as local, consultancy companies were invited to conduct this very important task as it represented the first and most vital stage in privatization. The cost of the latest study which was carried out by a British company in 1993 totalled \$170 thousand. These extra transaction costs have to be added to the total costs of the corporation which ultimately increases the doubts about its already doubtful solvency.

Moreover, with the lack of appropriate accounting records, particularly in the case of foreign debt and debt service, the delay in reaching a decision about privatization means another round of valuation is required. This vicious circle delayed the privatization of many establishments planned for divesture in Jordan.

6.6.1.2: The Need for Restructuring the Enterprise

Many of the firms targeted in the privatization programme are characterised by financial difficulties which make them unattractive to private buyers (local and foreign).

In the case of TCC, for example, the corporation has to change much of the existing telephone network in a number of Jordan's governorates before being able to proceed with privatization. Because of this the TCC has contracted different foreign companies to modernize the old equipment. It is planned to install a 17,000-line exchange in Ma'an, a 13,000-line extension in Amman, and more than 120,000 other lines by the end of 1994. The restructuring itself will cost more than \$300 million during the period 1993-1997 as the TCC's plan shows. Such an investment means that the total market value of the corporation must go up, thus making it more difficult for it to be sold to a local buyer.

Restructuring may be physical and lead to the fragmentation of the enterprise, as is the case with TCC, or it may be financial as in the case of the national airline (RJ). RJ has to capitalize its \$270 million debt which means that foreign ownership will exceed 49 percent and thereby contradict the Jordanian companies' rules and regulations. To solve this problem the consultant company studying the case for privatization proposed an increase in the airline's capital from the current \$22 million to about \$100 million so that the new capital would be consistent with the size of the company's operations. Such financial restructuring is a necessary step for privatizing the corporation in order to encourage foreign investors to buy into its equity.

Thus, the physical and financial conditions of the

targeted enterprises are serious factors behind the delay in the implementation of privatization.

However, in the case of the Public Transport Corp. (PTC), the privatization proposal was intended to include the restructuring of the whole transport sector rather than the corporation alone (Candoy-Sekse, 1988, p.35). Thus, the task of enterprise restructuring and rehabilitation may go beyond the boundary of the enterprise because of problems in the sector concerned.

6.6.1.3: The Lack of Regulatory Capacity

Jordan, as is the case in many developing countries, lacks the capacity to regulate a privatized utility such as one in the transport or the telecommunication sectors. Most of the corporations targeted for privatization in Jordan possess a heavy economic and political weight which may shift the parameters of regulation towards their benefits rather than those of the consumer.

Despite the advanced regulatory institutions available in developed countries regulating privatized utilities has proved to be a difficult task. In the United Kingdom, for example, regulatory bodies such as OFTEL and OFGAS are often in conflict with the privatized utilities when trying to regulate their monopolistic behaviour.

The question is whether the bureaucratic establishment in Jordan possesses similar capacity and competence to that which exists in the developed countries?

One of the reasons for delaying privatization is the need

to set a regulatory framework which suits the economic sector's concerns. In the case of TCC, the Jordanian private local companies doubted the ability of TCC's bureaucrats to provide a suitable mechanism for regulation (MEED, 23rd July 1993).

It may be argued that the need for an appropriate regulatory design may be solved by copying or amending regulatory models based on the experience of developed countries such as U.K., but the main problem lies at the implementation stage where the difference in bureaucratic efficiency, competence, and energy are of vital importance to the ultimate results. Even the design cannot be imitated in the majority of cases because it was established on a particular policy design derived from the specific sectoral features of the country.

The interest attached to regulation could stem from our analysis of the principal-agent theory in chapter 2.

In the absence of an effective regulatory mechanism, the asymmetry of information between the regulator and the enterprise will reintroduce the information asymmetry problem which dominated the relationship between the principal (government) and agent (manager) in the case of state ownership. The difference would lie only in the distribution of benefits from the state to the private monopoly and ultimately the shareholders.

In the absence of real competition or contestability the privatization of a monopolized industry may create more

problems than privatization intended to solve.

Thus, designing the appropriate regulatory framework for a telecommunications or airline corporation may take a long time before the mature stage of implementation is reached.

The reason why the Jordanian government does not have the opportunity to correct policy errors regarding inefficient regulation is because the size of their corporations and their numbers are not similar to those in Europe, for example, where the experience gained from every privatization case can be transferred to many more cases. Where foreign ownership is introduced, the bureaucratic capacity and efficiency to rectify policy errors may prove more costly for the Jordanian government than for a developed country's government. Part of the difference derives from their different bargaining positions in the privatization process and part from the abilities of their bureaucrats. All these factors have proved to be obstacles to smooth privatization in Jordan.

Another dimension of regulation derives from property rights literature.

As a developing country Jordan has the problem of defining property rights and all its subsequent entitlements. In western industrial countries, on the other hand, privatization does not require an entirely new legal framework to deal with such a situation because their societies as well as their economies have had two

centuries of gradual adjustments and now function according to a relatively well defined and advanced legal framework of property rights.

The objective of a) providing a supportive legal environment for property rights and contractual obligations and b) forming a commercial law for the settlement of disputes was never formulated in Jordan although it was one of the main requirements for privatization. This reflects the weak capacity of the country's regulatory body where, as North (1991) contended, an efficient system of property rights might offend the interests of the rulers.

Both dimensions regulation of enterprise operations and the introduction of an efficient system of property rights required an institutional building process rather than a privatization decree. Their absence in Jordan presented an obstacle to the implementation of privatization.

6.6.1.4: Inefficient Capital Market

In Jordan there is a capital market which was established before the idea of privatization emerged in the country. The Amman Financial Market (A.F.M.) is an independent public institution established in 1976 under special law no.31.

The establishment of the market was seen as a device to attract investors and traders who had been conducting their businesses in Beirut and left it after the start of the civil war in Lebanon in 1975.

Market capitalization as a percentage of GNP in the A.M.F. in 1990 was 22.8 percent (calculated by the researcher from A.M.F.,1990), which lies somewhere near the average for all emerging capital markets (25%-30%) (IFC, 1991). Moreover, turnover as a percentage of GNP, which had been 15.2 percent in 1989, dropped to 11.9 percent in 1990 because of the effects of the Gulf crisis (calculated by the researcher from A.M.F., 1991).

Another indicator, the depth of trade on this market (measured by market turnover as a percentage of market capitalization), was relatively high, standing at about 71 percent in 1990.

However, all these positive statistical indicators for the Jordanian financial market do not necessarily mean that it provides efficient and helpful support for privatization. There are questions which have to be asked in relation to privatization. Is there sufficient capital available to buy the enterprises, particularly those in the transportation and telecommunication sector planned for privatization? Is this market able to reflect the performance of management and increase their X-efficiency as happens in the industrial nations?

In any developing country the major question is the availability of capital to buy the public enterprises targeted for privatization.

There are three possible sources in the case of Jordan; local capital, Arab investment, or foreign capital.

The first possibility, the raising of local capital, does not seem to be promising since the banking and financial institutions in Jordan, although the most expanding in the economy, still suffer from many deficiencies: the narrowness of the money markets and the narrowness of the secondary market for money instruments as well as the inadequacy of the short term instruments in use (Ministry of Planning, 1986, p.74). Moreover, the Jordanian public is sceptical and aware of management practices within financial institutions as many financial scandals have occurred in the country. For example, the Petra Bank scandal in 1989/1990 put the bank into liquidation.

Another factor is the lack of long-term interest in productive activities shown by the holders of local capital. The search for fast-earning activities, particularly during the economic recession, impeded the government from privatizing its enterprises.

Moreover, local capital is relatively concentrated in Palestinian hands who give more weight to political factors than to economic criteria per se.

In summary, the shortage of domestic capital during 1986-1990 represented a major obstacle for the Jordanian plans of privatizing public enterprises.

After the increase in economic growth during 1991-1993, there is now more prospect for mobilizing local capital to buy the targeted enterprises.

Without any doubt, the Arab alternative depends strongly

on regional political spillover. Historically Arab countries and Arab investors have little interest in investing in other Arab countries. Thus, it is unlikely that Arab investors would be allowed by their governments, particularly in the rich Gulf states, to buy shares in such enterprises. This reflects the strong effects of the institutional factor on the running of the Jordanian economy.

The third and the last scenario is foreign ownership of the targeted enterprises. The difficulty of such a method of privatization comes from two dimensions. The first is the instability of the country's socio-political environment, particularly between 1989 and 1991, which causes foreign buyers to shy away from any major investment in Jordan. Also, the regulations regarding foreign investors still restrict majority foreign ownership in the country.

It is also the case that the concentration of the proposed enterprises in the transportation and telecommunication sectors does not allow the government to sell such important segments of the economy to foreign companies for complex socio-political as well as economic reasons. Young argued that the widespread foreign ownership of enterprises greatly contributed to the initial wave of nationalization in developing countries; thus privatization will inevitably invite charges of recolonization [(Young (1986) as cited in Hanke and

Walters (1990,P.105)]. This should be understood with the new wave of Islamicization in the country.

Thus, capital restrictions as well as the risk of crowding out private investment in the case of privatizing big enterprises played a major part in delaying the privatization programme.

The second dimension for the capital market is related to its ability to transform the information necessary to increase the pressure on managers which subsequently increases the efficiency of the firms. This is the most strongly declared objective of privatization.

The Amman capital market, as is the case in most other developing countries, is not similar in its efficiency to those existing in developed countries.

Civelek (1991) conducted an empirical study to examine the efficiency of the Amman stock exchange and asked the most important question regarding the success or failure of privatization, namely whether capital market prices can be relied upon to provide accurate signals about the optimal allocation of capital in the economy.

By examining the information effect on market prices for fifteen industrial companies listed on the market the scholar found the following; the market was thin and discontinuity in trading constituted one of its major features. Regulations governing the market prohibited any major movements in share prices. Consequently, the study

pointed out that the "stock prices established in the Amman Stock Exchange (ASE) do not appear to have any significance policy relevance" (Civelek, 1991, p.30).

The conclusion of this study is consistent with our perception of the market. As the market is small, there are two problems which seem to characterize it. The first is volatility. This means that the small size of the capital market makes share prices and transactions in general subject to immense fluctuations and this could be a result of manipulation by certain parties in the market. For example, while the government currently holds 48 percent of the shares, their sale will lead to the manipulation of specific interests which might affect the stability of the economy. Another reason for volatility is the effect of regional politics. For example, in the third week of January 1994 transactions in the Amman stock market shrank by 55 percent because of the Security Council's decision to extend sanctions against Iraq. Another influence was related to obstacles in the peace negotiations between Palestinians and Israelis about the control of trading routes between the West Bank and Jordan (MBC News, 24th January 1994).

The second problem emerging from the small size of the Amman capital market is that of short-termism.

In its study of Jordan the EIU said that;

" ... the Amman Financial Market, although resistance to anything but more tangible investments, such as those in bricks and mortar, still exists among the bulk of the population. Even among business people and financiers, the attractions of trade outweigh the uncertain promise of only long-term

profits on industrial investment" (EIU, 1992a, p.25). The problem facing the Jordanian government is precisely a result of this factor. It was short-termism and the merchant tradition of activities which led the government to undertake big projects and enhance its activities by owning the means of production. About 54 percent of the turnover of the A.M.F. in 1990 was in the financial, insurance and service sectors (calculated by the researcher from A.M.F., 1991).

All the above factors clearly demonstrate the limited room for manoeuvre available to the Jordanian government in its privatization programme.

6.6.2: The Non-economic Factors

Although it may seem that the Jordanian government lacks the will to implement the privatization programme, this is in reality not the case. The explanation may lie within the package of choices the government possesses in order to implement its policies. Apart from the economic reasons there are other socio-political or so called systemic factors which have also impeded the implementation of reform policies, including privatization, in Jordan.

Bery (1990) pointed out that

"what is seen from the outside as "lack of will" or commitment may in fact be the wisest course of action given such systemic factors. Outsiders are obliged to appreciate these systemic factors before exerting undue pressure and provoking failure" (Bery, 1990, p.1125).

What are these factors?

The crisis of unemployment and the increasing number of

people living below the poverty line impeded the government from proceeding with the privatization of its public enterprises during the period before the Gulf war, and brought privatization completely to a halt in the period from the end of the war until 1993.

Since public sector employment represents about one-half of total employment in Jordan, the implementation of privatization will be seen as a state retreat from its historical responsibility and a breach by the state of the social contract agreed between its leaders and the people, particularly in the absence of any unemployment benefits or effective social security system.

Although the government has attempted to balance differential social advantages and disadvantages, severe inequalities inevitably accompany privatization. An increase in the number of job seekers is linked with an unavoidable increase in the concentration of wealth and income.

In a socio-political environment similar to that in Jordan decision makers have historically been characterised by a vulnerability to internal and external events. The patron-client relationship and the distributive responsibility of the state stemming from its heavy dependency on external resources led the state to be the employer of last resort. This means that large numbers of people became totally dependent on the state for their income.

Such people, particularly the East Jordanians, are politically significant for the country's stability

because of their loyalty and support for the leaders which is based on their economic dependence on the state. In other words, there is a contract of shared benefits. So, privatization means a great gamble for politicians unless there is a careful policy design and a gradual mechanism for implementation.

The state in Jordan, although supportive of private initiatives, plays and will continue to play a key role in the process of economic and social development. Limited and carefully designed privatization is a rational political strategy for successive Jordanian governments and bureaucrats. The case in Jordan suggests that systemic factors based on state-society relationships may prove to be constraints on the choices of policy and policy implementation available to decision makers.

6.7: Conclusion

The purpose of this chapter has been to assess the process of privatization in Jordan. To achieve this objective, the opening section of the chapter investigated the role of the state in Jordan. Three dimensions were considered. The first measured the size of the state by its spending. From 1981 to 1990 government spending constituted 38.6 percent of the country's GDP, a high percentage compared with that of East Asian countries, for example. The study of state spending revealed that 75 percent was directed towards current expenditure and reflected a high level of military spending (25 percent) and a large number of government

employees. The Jordanian government plays the role of employer of last resort. With the absence of unemployment benefits and other social security schemes similar to those in western countries employment in the public sector is the only means of survival in a country characterised by a low capacity for employment generation in the private sector.

Through regulation the state distributes rents to its elite by licensing every aspect of the market in Jordan. The characteristics of the Jordanian state are similar to those which existed in Europe from the 16th to the 19th century and which still exist in contemporary Latin America. Legislation and restrictions on market forces form an integral part of the daily management of the economy. Thus, although the state believes in free enterprise and private initiative, markets are not free in Jordan. In the absence of free access to resources a transfer in the status of ownership will not necessarily mean more freedom of choice for consumers and producers. The state will still retain its power to influence private activities in the same way as in the public sector.

The state's role as owner of production evolved in Jordan through three phases. In the first (1921-1951) and the second (1952-1972) the main goal was not to own but to help and protect. However in the current phase, which started in 1973, the government took the initiative from the private sector because of the latter's inability to build a modern economy. Thus, the public sector is large,

mainly because of the great numbers of central government departments. At the sectoral level the government possesses a monopoly position in water, electricity generation, and telecommunications. It also participates through equity sharing in mining and the manufacturing industries. In real terms, although owned through shareholding, the government appoints, administers and finances most of those industries as part of its control of the commanding heights. However, it is still correct to argue that the allocative role of the state through direct ownership is limited in the country.

Privatization in Jordan was proposed in 1986 as part of the reform programme initiated by the government of P.M. Al-Rafai after it took office in 1985.

The study identified five factors which have played a major role in the consideration of privatization as a viable alternative; the economic recession in the country during the last half of the 1980s, the growing deficit in the central government budget, the huge burden of external debt, the need to attract foreign investment and finally the effect of western oriented bureaucrats on the decision makers.

In order to support our findings regarding the empirical evidence for privatization in chapter 3, an empirical study was conducted on one of Jordan's SOEs (Jordan Electricity Authority JEA) covering the period 1987-1992. This corporation is completely owned by the government and

represents a state monopoly in the electricity sector. The study found that there is an increasing trend of employment productivity and technical efficiency in the generation stations as well as a positive rate of return on the JEA's fixed assets. In spite of this there were huge losses during 1987-1991 attributed to heavy borrowing from external sources, and government pricing below marginal cost, as well as the effect of currency devaluations in 1988 and 1989 on JEA's in foreign currency liabilities.

Our study of the JEA as well as the review of other studies in Jordan leads to the conclusion that there is no clear-cut evidence that private ownership is superior to public ownership. Nor can it be claimed that a loss-making corporation is necessarily economically inefficient.

Empirical studies themselves are rare because of the monopoly position of most SOEs in a small-size market. Thus it is difficult to find like-with-like comparative studies.

An analysis of the financial performance of SOEs in Jordan revealed that losses are not restricted to pure state ownership but also occur in public shareholding companies which were established to maximize profits. Many reasons can be identified as the main causes of financial difficulties within public enterprises whether in the pure state sector or in public shareholding companies.

A complete record of government officials announcements on privatization is documented for the period from 1986 to

the end of 1993. The record shows that no single case of privatization took place in the country despite many government announcements at different times during this period. The latest announcement stated that 1994 will be the year of the first privatization experience in which the national airline will be transferred to private ownership.

In order to study the factors impeding privatization in Jordan the chapter grouped them into two categories. The first category was composed of economic reasons, which include factors related to enterprise valuation problems, physical and financial restructuring, the lack of an efficient regulatory capacity and the weakness of the capital market.

In the second category the delay in implementing privatization can be viewed as a rational decision given the kind of state-society relationship dominating in Jordan. This is particularly so since the private sector, which is characterised by short-termism and the search for quick and secure returns on investment, cannot in Jordan take over the role of the state at least in providing employment opportunities for the large army of unemployed. The expectation of the chapter is that privatization will take a gradual approach in Jordan and the state will continue to play a significant role in the management of the economy.

The new five-year Plan for 1993-1997, emphasised that the government should carry out the following

responsibilities; provide investment information, cut red tape and simplify the complexity of regulation, enhance competition in the market place, increase the investment in infrastructure, particularly for the agricultural sector and more investment in health and education or human development.

Privatization in Jordan, however, will be more related to the opening of new opportunities for private entrepreneurs through government support and incentives. The plan envisaged that the total gross fixed capital formation in the country will be 5.132 billion JDs during 1993-1997, 63.5 percent to be supplied by the private sector and 36.5 percent by the public sector (Ministry of Planning, 1994, p.156). The private sector will be allowed to participate in the implementation and the management of infrastructure. The plan envisaged a role for the private sector in the field of water distribution, the collection of water fees, cooperation between the private sector and the Telecommunication corporation (TCC) to give the former more participation in the construction of the corporation's projects and the provision of some selected services (ibid, p.141).

In such an environment privatization itself will be more related to creating the institutions necessary for better government through careful privatization design.

The current development plan (1993-1997), which was published in 1994, referred to the need to conduct a careful and detailed study about privatization in Jordan.

The main objective of the study will be to draw a clear conception of those public sector activities which are suitable for privatization; the strategic activities in which the state would continue its current role, but with additional emphasis on their costs and benefits; and the need to run current public activities on commercial grounds as a first step toward their full privatization (ibid, p.129). In order to achieve that there is a need for privatization in Jordan to be looked at in a wider context of participation and decentralization, which is the task of the following chapter.

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Chapter 7

Privatization, Decentralization, Participation, and Development in Jordan

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- 7.1 : Introduction**
- 7.2: Government Objectives on Decentralization
and Participation**
- 7.3 : The Design of Decentralization and Participation**
- 7.4 : Decentralization in Practice**
- 7.5 : Measuring Decentralization and Participation**
- 7.6 : The Effect of Privatization Policies on Participation
in Agriculture by Small Farmers**
- 7.7 : Dissatisfaction and the Institutional Role**
- 7.8 : Democracy, Participation, and Privatization**
- 7.9 : The Current Thinking of Decentralization
and Development**
- 7.10: Important Factors in the Relationship Between
Privatization, Decentralization, Participation
and Development**
- 7.11: Conclusion**

7.1: Introduction

Chapter four in the first part of this thesis concluded with the statement that development may mean decentralization and the latter certainly does mean participation, but that privatization will not necessarily secure participation. It depends on how it is designed and implemented.

This chapter will study this argument within the context of decentralization and participation in Jordan.

The question is whether privatization in Jordan would lead to decentralization and participation, and hence development. However, as there is no actual experience of privatization, the answer to the question will be hypothetical rather than based on concrete evidence, except for that of leasing state lands.

The chapter will outline government objectives on decentralization and participation, the policies pursued to achieve this, and whether they were successful or not.

The chapter will also measure the degree of financial decentralization in Jordan and the changes in the decentralization indicators between the period 1980-1984 and 1988. The main reason for this exercise is to investigate whether the decentralization objectives of the government in the 1986-1990 development plan were achieved or not and why. Part of the investigation will focus also on the process of project allocation on the local level and its relevance to participation and development.

Democracy and free market policies are two important

components of participation. However, the chapter will argue that in the case of Jordan the introduction of democracy or political liberalization since 1989 has been forced by pressure from below but in practice been used not as an instrument to increase popular participation but as a new means of increasing the centralization of decision making on the one hand and of speeding up the delayed process of economic reform, including privatization, on the other.

This issue will be investigated further by examining the objectives of decentralization, if there are any, in the more recent five-year development plan 1993-1997.

More attention will be given before concluding the chapter to the factors missing in the analysis of the relationship between privatization, decentralization, participation, and development:- reforming SOEs, bureaucratic reforms, and the importance of "crowding-in" the informal sector in the development of Jordan¹.

7.2: Government Objectives on Decentralization and Participation

It was argued in the previous two chapters that Jordan's approach to development has been top-down. The main reasons for this are;

- 1) The effect of colonial rule on the administrative structure as well as the historical and religious power of

¹"Crowding-in" the informal sector means increasing and supporting the establishment and the operation of microenterprises legally, financially and institutionally.

the leaders which has led to extensive centralization. The King appoints the cabinet and may also relieve it of its duties. He also makes appointments to the important posts within the country (e.g. government officials and judges) and can acquire further powers outside the constitution by declaring a state of emergency (York, 1988). Such power rests on the patron-client relationship vis-a-vis the country's traditional tribal leaders and other notables who constitute the ruling elite (Owen, 1992). It is this which makes Jordan similar to the European mercantile states of the 15th to 19th century where regulations were designed solely to maximize the benefits of the ruling elite.

2) The effect of the Arab-Israeli conflict and the complex effect of the Palestinian question on the state-society relationship in Jordan increased the tendency to centralize the decision making process.

3) One of the major reasons for centralization is the sources financing the government budget which will either lead to dependency on domestic sources (pressure for participation) or on external sources (state insulation) (Dessouki and Aboul Kheir, 1991). Dependency on exogenous sources of finance in Jordan led to less pressure on the government for participation in decision making because in many countries, particularly in the developed world, increased taxation means an increase in pressure from below for participation. In the case of Jordan the state, instead of taxing to raise revenue, became a patron which

distributed benefits on society, in particular by being the employer of half the workforce in Jordan. Furthermore, the drive to build the nation and its industrial base contributed to a more top-down approach towards development. Nevertheless, this factor represents the most powerful one because in the face of economic crisis pressure on government for participation through decentralization starts to mount and the voice option, according to Hirshman (1970), starts to activate and this is what happened after the decline in government revenue after 1982.

By the mid-1980s the revenue of the Jordanian state had declined because of the fall in oil prices and the negative effects of this denoted by the decline in external revenue. Inflation, unemployment and poverty increased as recession hit the economy. As a result, there was a tendency in the government to bring about more participation in the decision-making process. It was at this time that the idea of privatization was born.

Decentralization was viewed as a way to combine regional planning with sectoral planning and the preparation of the 1986-1990 development plan was conducted within such a context.

It is interesting that the Jordanian Ministry of Planning was working with the United States Agency for International Development and adopted USAID's Rural Development Strategy framed by Rondinelli (1984) and

entitled, "Urban Functions in Rural Development Strategy"² (Honey and Abu Kharmeh, 1989, p.80).

This provided positive evidence for the simultaneous imitation of both policies, privatization and decentralization, by Jordanian decision-makers and planners. This is fully consistent with the frame set by the World Bank, USAID, and the advocates of their line of thought.

While planning prior to 1986 was sectoral in base and goals, the fifth development plan (1986-1990) was regional and denoted the first phase of establishing a system for regional planning in Jordan. Thus, it was regarded as a departure from the old system of sectoral planning which had characterised previous national plans.

There were two main principles in this plan which revealed the decision-makers' and planners' vision of decentralization and participation.

The first is the principle of social justice which perceived that territorial decentralization contributes to the achievement of a more balanced distribution of the fruits of development, particularly in circumstances where the landowners, the trading and the business communities have benefited substantially more than rural people. So, planners viewed territorial decentralization by increasing the base for people participation in the initiation,

². The strategy calls for injecting investments in smaller towns of the rural regions as well as improving the communication, transportation and trade linkages (Honey and Abu Kharmeh, 1989).

formulation, implementation and monitoring of the projects. That will lead to more efficiency in the distribution of services and to more social equality. In the words of the plan document

"Realizing social justice in all regions of the Kingdom and ensuring a balanced geographical distribution of social and economic services through regional development, promotion of popular participation in the formulation, implementation and follow-up of overall development programs and adoption of regional planning methods to direct future development at the national, regional and local levels" (Ministry of Planning, 1986, p.78).

The second principle was based on people as the means and objects of development. Thus it called for popular participation as a way to increase human capabilities and choices. The plan stated popular participation to be the;

"Enhancement and expansion of popular participation in the various phases of the planning process as well as in decision-making, determining of priorities and monitoring the implementation of development projects and programs. The emphasis on popular participation stems from the concept that man is the mean and object of development. He is the means by participating in the planning process, contributing as much effort as he could, and he is the object because he reaps the achievements of development in the form of employment opportunities and appropriate income" (ibid, p.114).

Another vision of decentralization and participation is available from an interview with Crown Prince Hassan of Jordan.

In reply to a question in August 1988 about his opinion on decentralization in Jordan he stated that;

"There has to be an effort made to move people out of high population areas-hence the importance of regional planning. I still feel that greater participation is essential on the part of the local elected bodies. (the problem) is what available in terms of finance... One of my major disappointments ...is the inability to monitor the (planning) process in the regions" (Interview with Crown Prince Hassan, 1988, p.7).

Concerning the future of the decentralization process he said;

"I hope the government will take the necessary decision on this all-important subject to allocate a decentralised budget more effectively to regional councils and provided the necessary staffing to assist those councils"(Interview with Crown Prince Hassan, 1988, p.7).

Both answers revealed that there was no true commitment on the side of the state to empower people at the local level, firstly because financial constraints do not mean that priorities at the local level cannot be selected by the local people despite the funding shortages (Cernea, 1991, pp.9-10). Secondly, in his first answer the Crown Prince expressed the wish to continue monitoring the planning process even at the local level. This ultimately leads to central intervention in all aspects of planning as we shall see in the implementation or practical part. It is the decision-makers' vision of decentralization and development in general which leads to more centralization. This is because it is development from above. What is needed is empowerment, not a programme conducted from above and evaluated from above. There is a need for a real spatial reversal to the "local scale" in village councils. The question, therefore, is whether there was a failure in

the design or the implementation.

7.3: The Design of Decentralization and Participation

There were four levels in the hierarchical system established to coordinate the plan (Honey and Abu Kharmeh, 1988) (Honey and Abu Kharmeh, 1989).

At the national level there was the Ministry of Planning with officials and experts who held the upper hand in the ultimate decision-making processes. The Ministry developed a geographical information system (including a locational network with all settlements) which depended on field level surveys as well as information provided by other ministries.

The second level in the top-down hierarchy was the governorate level. There are eight governorates considered to be regional planning agencies. Their main task was to update data for the Ministry of Planning files. The governorate structure possessed only a modest planning staff, but they were still important as a territorial division to provide state services for the regions.

The third tier in the planning system was the subdivision of the governorates, nominated as development subregions. Each one had a "development council" consisting of public and private leaders. These were new territorial units. The selection of these territorial units was based on two principles, the first was physiography (valley, highlands or desert) and the second spatial linkages. There were according to those two principles 37 subregions, as

illustrated in table (7.1). However, in theory, the councils were expected to identify development plans for their respective territories mainly to enhance employment opportunities and increase income. At the same time, they had to work with the governorates and the Ministry of Planning to find financial support (domestic and foreign) for the implementation of the plans.

The last level in the hierarchy of regional planning was the development cluster of villages, known as "development units". Each unit had a representative on the respective development council. This level was seen chiefly as an information line rather than a level of any executive power.

From the design point of view it could be said that the plan had the potential to provide the appropriate structure as well as a solid base for territorial decentralized development. That would have been so if the assumption had matched the intentions of the decision makers. However, this was not the case as the implementation process revealed.

7.4: Decentralization in Practice

It is known that the inclusion of a proposed activity in any development plan is not a guarantee of its implementation. The Jordanian 1986-1990 development plan although sound in its design, could be assessed as a successful failure from the implementation aspects.

Table 7.1
Regional Planning Units in Jordan Development Plan
(1986-1990)

Governorate	Sub-regions	No. of development units	No. of villages	
Amman	Amman	1	52	
	Ma'adaba	8	143	
	Na'our	4	38	
	Sahab-Muwaqqar	2	25	
Sub-total	4	15	258	
Zarqa	Zarqa	5	36	
	Dulail	1	7	
	Azraq	1	6	
Sub-total	3	7	49	
Irbid	Irbid First	5	28	
	Irbid Second	6	42	
	Ramtha	2	6	
	Bani Kananah	3	21	
	North Ghors	4	4	
	Koura	4	31	
	Ajloun	6	53	
	Jerash	8	55	
	Sub-total	8	38	283
	Mafraq	Mafraq	6	76
		North desert	8	73
Sub-total	2	14	149	
Balqa	Balqa Ghor	7	25	
	Balqa Middle	7	40	
	Balqa'a Basin	4	17	
Sub-total	3	18	82	
Karak	Karak	1	38	
	Qasr	3	22	
	South Mazar	3	41	
	Ay	1	6	
	Safi	2	10	
	Desert	1	5	
	Sub-total	6	11	122
Tafila	Tafila	3	23	
	Bsairah	2	10	
	Hassa	1	3	
Sub-total	3	6	36	
Ma'an	Ma'an	3	17	
	AL-Husseiniat	1	6	
	AL-Shoubak	1	21	
	Wadi Mousa	2	18	
	Desert		13	
	Aqaba	1	14	
	Quwairah	1	6	
	Wadi Araba	3	9	
Sub-total	8	15	104	
Grand Total	37	124	1083	

Source: Honey and Abu Kharmeh (1988, p.279).

Jreisat (1989) argued;

"Once more, the proposed projects and measures in the plan are devoid of empirical content, reasoned justification, or assessment of expected outcomes at any level of tentiveness. The general approach is basically of the traditional, legal genre of prescriptions that lack an action oriented, conceptual sophistication, or substantive relevance; hence, they are old remedies of proven inadequacy" [(Jreisat, 1989, p.97) from (Jreisat, 1988)] (emphasis added).

The failure to achieve decentralization and participation could stem from the field studies conducted in Jordan during the period 1989-1991. These emphasized the lack of power at the local level to alleviate the problems facing people in villages such as the lack of social services and other important infrastructural requirements such as roads (AL-Edwan, et al., 1990) (Sadik and AL-Kasawna, 1990) (AL-Ahmed, et al., 1989) (AL-Ahmed, et al., 1991a) (AL-Ahmed, et al., 1991b).

All the studies pointed out the powerless status of local authorities and institutions from their establishment to their budget and plans.

1.The Establishment of the Village Council: This requires a request from at least 2500 people in the area to the municipalities' minister through the governor of the village. The minister establishes a committee which advises him on the case for establishment. Later the minister makes a recommendation to the cabinet which then decides whether to establish the council or not. After the establishment decision the municipality minister sets up

a two-year administration for the village; an election is then held to choose the administration. However, the minister still possesses the right to approve or reject the elected council. In addition, there are two members on the village council who are appointed by the minister himself but are subject to the national regulations governing the civil service.

2. The Relation with the Municipalities Ministry: This ministry controls all the municipalities in Jordan. The staff of the municipalities are appointed by the ministry.

3. The Relation with the Ministry of Interior: The relation of this ministry with rural Jordan is through the administration governors. In addition to maintaining the rule of law, the governors control the civil servants in the municipality. The most important point is that the head of the municipality cannot initiate any project costing more than five thousand Jordanian Dinars (JDs) without the approval of the governor. The governor is also responsible for the relationship with the Municipalities Ministry on project funding. The role of the governors in the southern regions, as revealed by the study by Sadik and AL-Kasawna, is more important than in the northern regions (Sadik and AL-Kaswana, 1990, p.53). That explains, at least partially, the relationship between greater poverty in the south and excessive centralization.

4. The Budget of the Municipality Councils: Although the municipalities proposed the projects and explained their advantages to the rural people in the area, the Municipalities Ministry often altered the proposed projects in order to be more consistent with the national plan. The Ministry issued their final plan for implementation. However, even with such excessive centralization 94 percent of the heads of the municipalities believed that this method was a decentralized approach while the 6 percent who did refer to excessive centralization were in the municipalities of Amman, Irbid and Mafraq (ibid, 1990, p.57). This explains the consistency in the objectives of the ruling elite whether at the central or local level.

In summary, government below the national level is not local government as is the case in western countries. In Jordan it is much more of a local administration composed of bureaucrats executing government policies from the centre. Thus, the goals of the plan in initiating, planning, implementing and monitoring did not find any place in practice.

7.5: Measuring Decentralization and Participation

The UNDP (1993) in its Human Development Report listed a number of indicators to measure financial decentralization in local government. However, the report referred to the scarcity of information regarding local government in developing countries as is the case in Jordan. In this

section we will first measure financial decentralization in local government for the period 1980-1984, then we will construct more detailed local data for 1988. We will calculate the data for the national level by using the data provided by Sadik and AL-Kasawna (1990) in their study of 50 Jordanian Municipalities³. We will also examine whether or not funds granted to local governments are directed towards the provision of basic needs such as health, education, sanitation and clean water. The emphasis on basic needs derives from their link with participation and our concept of bottom-up development.

7.5.1: Decentralizations indicators

In the case of Jordan we will employ five indicators to measure the degree of financial decentralization.

1. The expenditure decentralization ratio (EDR) = $\frac{\text{Local government expenditure (LGE)}}{\text{Total government expenditure (TGE)}}$

2. The modified expenditure decentralization ratio (MEDR) = $\frac{\text{Local government expenditure (LGE)}}{\text{Modified total}}$

³It is important to mention that there are no data available on the expenditure and revenue of municipality councils after 1984. Furthermore, even the new five-year development plan (1993-1997), published in February 1994, does not contain any information regarding municipality expenditure and revenue. Thus, the construction of the data for 1988 becomes important for two reasons, the first is for comparative purposes as many of the decentralization ratios asserted in UNDP (1993, table 4.2, P.69) were for 1988. The second reason is to assess whether the objectives of the 1986-1990 development plan regarding decentralization were implemented, at least in financial matters, as it was a failure from the territorial side.

government expenditure (TGE _ defence and debt servicing expenditure).

3. The revenue decentralization ratio (RDR) = Local government revenue (LGR) / Total government revenue (TGR).

4. Financial autonomy ratio (FAR) = Local government revenue (LGR) / local government expenditure (LGE).

5. Proportion of total expenditure controlled by local government (PTECLG) = (FAR) multiplied by (EDR).

7.5.2: Decentralization Ratios (1980-1984)

As many aspects of the relationship between the centre and the local level in Jordan cannot be quantified, table (7.2) sets out the expenditure decentralization ratio which measures the proportion of expenditure spent by local government to that spent by central government. However, there are two kinds of expenditure decentralization ratio. The first is the expenditure decentralization ratio (EDR), and the second is the modified expenditure decentralization ratio (MEDR). The first, EDR, does not discriminate between central government expenditure that cannot be decentralized such as military expenditure and debt servicing payments, or that could be decentralized, such as health, education, and development projects. Thus, EDR has to be modified in order to take the military and debt servicing expenditure

out of the central government total spending. Thus, MEDR (Modified expenditure decentralization ratio) is more appropriate for assessing the real proportion of finance that the centre can allow the local level to assume responsibility for spending.

In the case of Jordan, table (7.2) shows that EDR in Jordan is very low although the central government spending figures did not include the debt servicing expenditure. This means the EDR will become lower if the debt servicing payment is included. During 1980-1984 the EDR did not reach 7 percent. Even when military expenditure is deducted, the MEDR figures show that spending in Jordan is highly centralized. The average MEDR for 1980-1984 was only 8.3 percent. Thus, the decentralization of public expenditure in Jordan is extremely limited. A summary of the main reasons for this was set out in the first section of this chapter, but it is important to mention that the increase in transaction costs, when spending is decentralized, has to be taken into account. In other words, decentralization policies go against the rulers' rule of the game (maximize revenue and minimize transaction costs)⁴.

Likewise, in the case of the revenue decentralization ratio (RDR), which measures the importance of local government revenue to that of central government. The RDR figures in Table (7.3) provide further evidence for the

⁴This argument is mainly derived from North (1989, 1991) and explained in detail by chapter 1 of this thesis.

Table 7.2
Expenditure Decentralization Ratios in Jordan
(1980-1984)
(MJDs)

Years ----- Details	1980	1981	1982	1983	1984
Amman	15.7	21.1	20.6	22.8	24.1
Zarqa	1.7	2.1	3.4	3.1	3.3
Irbid	4.0	5.9	8.3	10.1	10.1
Mafraq	0.7	0.9	1.0	1.2	1.2
Balqa	1.6	1.1	1.5	2.0	1.5
Karak	0.9	0.9	1.2	1.7	1.5
Tafila	0.3	0.4	0.8	0.4	0.7
Ma'an	0.6	1.0	1.5	0.9	1.8

[1] LGE (MJDs)	25.5	33.4	38.3	42.2	44.2
[2] TGE (MJDs)	487.9	546.2	632.0	656.2	640.6
[3] MTGE (MJDs)	352.7	408.0	470.2	488.2	463.1
[4] EDR (%)	5.2	6.1	6.1	6.4	6.9
[5] MEDR (%)	7.2	8.2	8.1	8.6	9.5

Sources:

[1] Local government expenditure (LGE) figures from Ministry of Planning (1986, Table no.6, p.398).

[2] Total government expenditure (TGE) figures from IMF (1991, p.346).

[3] Modified total government expenditure (MTGE) figure calculated by the researcher after deducting defence expenditure from (TGE) as the latter figures do not include debt servicing in the first place (IMF, 1991, pp.345-347).

[4] & [5] Expenditure decentralization ratios (EDR) and modified expenditure decentralization ratio (MEDR) are calculated by the researcher.

Table 7.3
Revenue Decentralization Ratios in Jordan
(1980-1984)

Years ----- Details	(MJDS)				
	1980	1981	1982	1983	1984
Amman	13.6	15.5	21.2	21.9	29.2
Zarqa	1.7	2.3	3.0	3.1	3.1
Irbid	3.6	5.8	6.9	9.5	9.0
Ma'fraj	0.6	1.3	1.0	1.1	1.2
Balqa	0.8	0.9	1.5	1.5	1.3
Karak	0.7	0.8	1.0	2.0	1.4
Tafila	0.3	0.5	0.7	0.4	0.6
Ma'an	0.6	1.3	1.4	1.7	1.8

[1] LGR (MJDS)	21.9	28.4	36.7	41.2	47.6
[2] TGR (MJDS)	507.0	591.2	627.1	674.4	643.3
[3] RDR (%)	4.3	4.8	5.9	6.1	7.4
[4] FAR (%)	85.9	85.0	94.6	120.5	107.7

Sources:

[1] Local government revenue (LGR) figures adopted from Ministry of Planning (1986, Table, no.4, p.396).

[2] Total government revenue (TGR) figures adopted from Central Bank of Jordan (1989, Tables 37 & 38, pp.45-46).

[3] & [4] Revenue decentralization ratios (RDR) and financial autonomy ratios (FAR) are calculated by the researcher.

argument presented throughout the second part of this thesis, namely that Jordan's high dependency on external sources of finance increased the tendency towards centralization. The RDR average was only 5.7 percent during 1980-1984.

Another indicator shown in table (7.3) is the financial autonomy ratio (FAR) which measures the degree of local government control on local spending. It appears that Jordanian municipalities are highly autonomous in their spending as the FAR was 98.7 percent during the period 1980-1984.

Two important factors have to be pointed out: the first is that this ratio (FAR) is high because local government spending was very low when compared with central government spending, and the second is that the figures for local government revenue imply, in the case of the data for Jordan, revenue transferred by central government to the local level. This is why more detailed data is needed to show the percentage of local government revenue (collected by the local government itself) against total revenue which includes transfers from other sources.

Another indicator which shows the proportion of total expenditure controlled by local governments is (PTECLG). This reveals that the ratios were 4.5%, 5.2%, 5.8%, 7.7% and 7.4% during the period 1980-1984.

All the above indicators of decentralization depict very limited financial powers for local governments in public spending and revenue collection during the period 1980-

1984.

7.5.3: Estimated Decentralization Ratios for 1988

Since 1984 there have been no figures available regarding the expenditure and revenue of local governments in Jordan. We have therefore estimated the data by relying on the information collected by Sadik and AL-Kasawna (1990) from a sample of 50 municipalities constituting 29.1 percent of the total municipality councils in Jordan and about 10 percent of the total municipality and village councils which totalled 516 in 1988.

7.5.3.1: The Methodology of Estimation

In the original study the authors calculated their figures directly from the local authority budgets. They distributed the councils in the sample between the eight Jordanian governorates. We calculated the per capita expenditure and revenue for each municipal and village council included in the sample. We then multiplied the figures for per capita expenditure and revenue by their counterparts at the governorate level. We calculated all the expenditure and revenue ratios as well as the shares for each kind of expenditure and revenue source and then related them to the governorate in the sample. By totalling the data for the eight governorates we produced the figures to be used in measuring the different decentralization ratios at the national level for 1988.

7.5.3.2: Expenditure Decentralization Ratios

One of the important indicators derived from the expenditure figure and the number of councils in table (7.4) is that per capita council spending varied widely between the eight governorates. In Amman governorate, average council spending was the highest in Jordan (98.7 thousand JDs), while in Zarqa, an industrial governorate, the spending was only 26.9 thousand JDs. Another important indicator from the table is that related to the notion of expenditure.

On average, the current expenditure share of the local authorities total expenditure amounted to about 47 percent while that spent on development projects was only about 22 percent.

If we assume that all development expenditure was allocated to the social priority projects such as health and education, which is not true in practice, then Jordan's local government social allocation ratio (social expenditure/ total expenditure) would be similar to those in Kenya and Malawi in 1989 and 1984 but less than those in Chile in 1988 (31%) and Zimbabwe in 1986 (34%) (UNDP, 1993, table no. 4.4, p.71). In comparison with the industrial countries, the social allocation ratio in Jordan was about half the ratios in Germany (47% in 1988) and the United Kingdom (43% in 1989) (ibid).

Measurement of the EDR revealed that the percentage of local government spending to that of total government was small at 3.5%, which is about half that for 1984.

Table 7.4

Estimated Municipal Councils Expenditure
According to Jordan's Governorates for 1988.
(Thousand JDs)

Governorate ----- Details	Amman	Zarqa	Irbid	Mafraq	Balqa	Karak	Tafila	Ma'an
No. of Councils	85	19	161	73	54	66	16	42
Total Local expenditure (MJDS)	8389.5	511.1	8082.2	4547.9	4438.8	3471.2	1004.8	1625.4
Average Council expenditure	98.7	26.9	50.2	62.3	82.2	52.6	62.8	38.7
<u>Expenditure Share (%)</u>								
Current	42.9%	54.1%	45.0%	39.4%	44.6%	38.6%	34.1%	46.9%
Capital	5.4%	26.8%	3.5%	2.5%	5.7%	7.4%	1.5%	0.7%
Development	19.4%	2.0%	24.2%	18.6%	20.0%	28.7%	16.7%	28.3%
Others	32.3%	17.1%	27.3%	39.5%	29.7%	25.3%	47.7%	24.1%
----- Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: All figures are calculated by the researcher employing the sample data in Sadik and AL-Kasawna (1990).

In comparison with other developing countries the EDR in Jordan was lower than in the majority of developing countries (14 out of 17) listed by the UNDP (1993, Table no. 4.2, p.69). Even after deducting military expenditure from total government spending in 1988, the MEDR for Jordan was only 4.8% which is the lowest among the seven developing countries listed in the Human Development Report of 1993. The explanation for such a low ratio in Jordan is that the reduction in local government expenditure was enforced by central government because of the recession which developed in the country after the mid-1980s.

7.5.3.3: Revenue Decentralization Ratios

A number of interesting observations can be derived from table (7.5). The first is that total local authority revenue in Jordan was 33.3 MJDS in 1988. This means the RDR was only 4.1 percent, which is also less than it was in 1984. In comparison with other developing countries Jordan's RDR was less than that of South Korea (31%), Zimbabwe (17%), Algeria (16%), Bangladesh (8%), while more than that of Brazil (1%), Ghana (2%) and Costa Rica (3%). However, the most important observation is that related to the structure of revenue sources for local councils.

All local councils in Jordan were highly dependent on central government to provide them with revenue because they had no powers to collect taxes. About 59 percent of local Council revenue came from government while only 15

Table 7.5

Estimated Municipal Councils Revenue in Jordan
According to Source of Revenue in Each governorate
for 1988

(Thousand JDs)

Governorate	Amman	Zarqa	Irbid	Mafraq	Balqa	Karak	Tafila	Ma'an
----- Revenue source								
Total revenue	8381	484.5	10061.9	4555.2	3681.2	3367.8	1190.4	1579.6
<u>OF which</u>								
Government	4097	383.8	5957	2963.8	2516.4	2516.4	680.0	1142.4
% of total	49%	79.2%	59.2%	65.0%	68.3%	68.3%	57.1%	72.33
Municipality	2023	66.5	1360.5	562.1	804.6	402.6	92.8	193.2
% of total	24.1%	13.7%	13.5%	12.3%	21.4%	12.0%	7.8%	12.33%
Extraordinary *	2261	34.2	2744.4	1029.3	360.2	448.8	417.6	244
% of total	26.9%	7.1%	27.3%	22.7%	10.3%	19.7%	35.1%	15.34%
Total share	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: All figures are calculated by the researcher employing the sample data in Sadik and AL-Kasawna (1990)

* Extraordinary revenue includes; projects revenue; interests, grants and aid; and loans.

percent was collected by the local authorities. In the extraordinary revenue category, revenue from capital projects did not account for even one percent of total local revenue while the other main source of revenue was the loans which constituted about 19 percent of total municipality and village council revenue. Thus, the financial autonomy ratio (FAR) calculated for Jordan during the period 1980-1984 is highly misleading because local council revenue does not equal local council revenue raised by local taxation. The first produces an FAR equal to 104 percent while the second gives an FAR of only 15.5 percent⁵.

7.5.4: The Allocation of Projects at the Local Level and the Issue of Participation and Development

In the "Human Development Report" of 1993 the UNDP stated that investment at the local level, particularly through borrowing, may lead central government to lose "control over the national creation of credit-and macroeconomic management" (UNDP, 1993, p.74).

The report suggested that special funds for investment such as the one in Jordan called "Cities and Villages Development Bank" might provide an alternative means of financing investment at the local level. The report went on to assess the results of this development bank in the

⁵In the first method: FAR= 33.3 MJDS (Local government revenues) / 32.1 MJDS (local government consumption= 104%. In the second method: FAR= 33.3 . 0.15/ 32.1 = 15.5%.

following oft quoted words;

"This has helped finance improvements throughout the country, bringing roads, schools, clinics and water supplies to even the smallest and most remote communities" (UNDP. 1993, p.74).

In order to examine the extent of the success referred to by the UNDP in the Cities and Villages Development Bank of Jordan table (7.6) provides detailed data on the kind of projects invested in by the Bank. The argument of this chapter as well as the entire thesis is that providing basic needs, such as medical centres, schools, clean water, electricity and sanitation as well as roads and other infrastructures, is the *most important step towards enhancing the capabilities, capacities and choices of the people*. From the table, it is clear that loans allocated for investment in roads constituted about 40 percent of the total. Such investment is essential for local people in rural areas. However, loans allocated for investment in basic needs were 1.5 percent in electricity, 0.5 percent in schools. There was no investment in water, sanitation or the construction of medical centres. It seems, therefore, that investment in human development at the local level is weak in Jordan. Instead the central government provides such investment directly. As a result of this top-down approach, many field studies in Jordan's rural areas pointed out that shortages in the provision of basic needs at the local level led to internal migration to the urban centres (AL-Lawzi, et al., 1989) (AL-Tayeb, et al., 1990).

Table 7.6

Allocation Notion of the Loans Given By Cities
and Villages Development Bank to Jordan's
Municipalities

(Thousand JDs)

Municipalities of ----- Project notion	Amman	Zarqa	Irbid	Mafraq	Balqa	Karak	Tafila	Ma'an
Roads	269	135	960	848	477	103	35	20
Electricity	67	16	0	0	24	0	0	0
Water	0	0	0	0	0	0	0	0
General Buildings	0	0	42	50	0	12	0	0
Sanitation	0	0	0	0	0	0	0	0
Schools	0	0	12	0	7	14	0	0
Medical Centres	0	0	0	0	0	0	0	0
Productive	550	0	589	247	50	0	100	0
Others	229	100	1506	159	68	303	0	75
=====								
Total	1115	251	3109	1304	626	432	135	95

Source: Cities and Villages Development Bank (1987, table no.9, p.26).

Thus, the success of Jordan's approach for allocating projects to the rural areas have been overestimated by UNDP (1993). The problem for this bank as for other specialist development banks in Jordan is that the centre determines the projects to be implemented with the priorities set by planners and other decision makers at the national level.

For example, investment in productive projects, which constituted about 21.7 percent of the total loans allocated by the bank in 1987, is usually based on an allocation suggested by the development plan. Thus, there is no participation for people at the local level either in the initiation, implementation, and monitoring or in the evaluation of success and failure. All the phases of the project are discussed and agreed on by bureaucrats at both levels, central and local. That is because local councils and municipalities are not local government but local bureaucrats. They form part of the Jordanian government's apparatus for centralization rather than for decentralization. Thus, the UNDP assessment regarding the role of the bank in providing basic needs was not completely true.

Another criticism of the Cities and Villages Development Bank in Jordan stems from the highly distorted and unequal distribution of loans among the governorates. In the southern governorates, Karak, Tafila and Ma'an together received less than 9.5 percent of the total loans allocated by the bank.

Given the status of poverty and the low level of development in the southern region there is no reason why a greater proportion of investment should not take place in the southern region. The only reason we can give is the effect of powerful interest groups in the centre on loan allocation decisions. Such a conclusion is consistent with the history of centralization and the features of administration in Jordan.

7.6: The Effect of Privatization Policies on Participation in Agriculture By Small Farmers

The consistency between privatization or market-oriented policies and functional decentralization as proposed by the World Bank and its advocates has had a negative effect on small farmers in rural Jordan⁶.

Leasing government lands to *capitalist farmers* in the irrigated areas led to a more unequal distribution of landholding and thereafter of wealth and income in the country. The UNDP (1993, table no. 2.2, p.29) placed Jordan among the countries with high inequality in the distribution of landholding, 0.57 on the Gini Coefficient measurement⁷. A policy of privatization through the leasing of unused state land is not an alternative to a land reform programme. However, Lipton (1993, p.644)

⁶For more discussion on the differences between functional and territorial decentralization see chapter 4.

⁷ Gini Coefficient measures the inequality in distribution. Its value ranges from 1 (highly unequal) to zero (very equal).

argued that land privatization (i.e., leasing) can be classified as land reform "only if it is invoked at the option of small farmers" (emphasis added). This was not the case in Jordan, but land privatization led to a greater deterioration of the incentives to small farmers in Jordan.

Two important negative consequences were the result:

The first is that, while many Jordanian small farmers have abandoned farming because they cannot afford the debt forced on them by the middlemen and merchants in the rural areas, there were 150 thousand foreign workers in Jordan mainly working as wage farmers. Crown Prince Hassan in a 1988 interview admitted the negative impact of the problem.

"With 150,000 workers from abroad largely in agriculture. I feel that something is tragically wrong. The incentives are obviously not viable for Jordanian farmers. This is something that has to be looked at" (Interview with Crown Prince Hassan, 1988, p.8).

The second negative consequence is that commercialization has led to an emphasis on more efficient, profitable, modern (technically), high-yield crops. As a result government loans have been directed toward the capitalist farmer elite. This trend has led farmers to move from self-sufficiency and semi-subsistence farming to a dependency on commercial farming. The latter includes all the risks arising from the new crops as well as the need to engage in marketing.

North (1989, p.1321) argued that such developments lead to

the break down of personal exchange and its most important effect is the "break down of communities of common ideologies and of a common set of rules in which all believe".

Both spelled disaster for the small farmers. In the case of marketing, dependency on the State Marketing Board led to groups lobbying so as to gain first access to the market with high prices. Even after the dismantling of the State Marketing Board in 1989, capitalist farmers remained powerful groups in the agricultural sector. It should be explained that it is not ownership per se, but government centralized policies, which favour capitalist farmers.

The latter lobby to secure access to government loans as well as to secure the marketing of their products (in particular at the beginning of the cultivation season) at home and abroad. This has left small farmers in an unequal position and is consistent with what North (1989, p.1321) said, "the rise of impersonal rules and contracts means the rise of the state, and with it unequal distribution of coercive power".

Participation in the context of privatizing or leasing state land (the free choice principle of participation) failed because the policy was not complemented by territorial decentralization through which local organizations of small farmers can be active enough to achieve free choices for their members. This problem might be overcome if leasing were to be based on decisions by local bodies governed by an efficient system of checks and

balances (Nugent, 1993).

Another problem unsolved by privatization is the government food pricing policy which contributed to the shift from subsistence to commercial farming. Cheap food for the urban sector led the country to increase its share of food imports. Moreover, the policy of food aid from countries such as USA to Jordan contributed to the transfer from subsistence to commercial farming. Wheat production has declined to the extent that the country could only provide 14 percent of its actual consumption during the period 1981-1985 while for barley the ratio of self-sufficiency was only 18 percent. For other field crops (including corn and Soyabean) the ratio of self-sufficiency for the same period was only 6 percent (Ministry of Planning, 1986, p.536).

Supporters of the commercialization of agriculture such as the experts in the Ministry of Agriculture in Jordan, have come to believe that farms with an area of less than 4 (ha.) are inefficient and unprofitable (Honey and Abu Kharmeh, 1988, p.76). In reality more than half the farms in Jordan fall below this level and this is an obvious contradiction between what the experts believe, using their modern knowledge, and what the poor need. The latter basically need to enhance their capacity to use their traditional experience and knowledge. However, this problem has also been identified by the Crown Prince of

Jordan.

"More work is needed to develop a policy which is relevant to the bulk of small producers—mainly subsistence farmers who can not afford the outlays necessary for modern production" (Interview with Crown Prince Hassan, 1988, p.9).

It is the Jordanian decision-makers, planners and experts who have proved unable to work out an approach which is committed in reality to a spatial reversal. Jordan's decision-makers have always regarded modernization as the subject and people as the object. There is need for a shift in real policies to put people first rather than modernization, a manipulative technology, and a deficient centralization. As Uphoff (1993, p.619) has stated, the goal should be to achieve a *positive-sum outcome* which government programmes and the working of market forces alone cannot.

The use of market forces as a way of increasing participation does not work because the existence of product surpluses and deficits within centralized policies for the benefit of the rich in itself distorts the market forces.

As long as there is a lack of healthy local organizations and institutions, and territorial decentralization is weak or does not exist, the universal solution of "getting the price right" will fail to achieve a sustainable level of development particularly in rural areas. Small Jordanian farmers are the main losers from the privatization of land.

7.7: Dissatisfaction and the Institutional Role

The enforcement of Western models of development in Jordan has eroded traditional Islamic values and undermined the Jordanian people's confidence in themselves and their cultural heritage. They have had their values and norms denied to them by Western attitudes of cultural superiority reinforced through an alien system of institutions and material welfare.

Particularly in rural areas, there is a "power of belief" in Islamic values. These values do not operate in a similar way to those modelled by rational choice theory or the context of individualism inherent in public choice theory.

Institutionalists emphasise the importance of studying the characteristics of social institutions in order to understand the evolution of society and its institutional change.

Nabli and Nugent (1989, p.1335) argued that there are three characteristics which could be considered basic to the concept of a social institution. The first is the rule and constraint nature of institutions; the second is the ability of institutions to govern relations among individuals and groups as well as being applicable in social relations and the third is their predictability where the rules and constraints have to be understood, at least in principle, to be applicable in repeated and future situations.

In the rural Jordanian communities there exists social responsibility and accountability. Individuals must voluntarily curtail their own freedom in order to maximize collective freedom. Participation in this sense will not be valued individually but collectively. Until today the head of the family is respected and is able to enforce his decisions on family members because denying recognition to the father of the family means denying recognition to the other members of the family. There is a feeling of security in belonging to a family and community. In Jordan these needs cannot be enhanced and worked to their full capacity when alien values and models of development are introduced.

In these communities there are rules and norms which from a western point of view work irrationally.

For example, in a field study about the socio-economic conditions in Tafila governorate in the south conducted in 1989 AL-Ahmed and his colleagues found that only 33.5 percent of the total households in the sample covered by the study (1147 households) took loans and most of these were working in military service. This was because most of the families did not believe in paying interest on loans for religious reasons as Islam prohibits transactions based on financial interest (AL-Ahmed, et al., 1989, p.76). Other field studies of rural areas in Jordan reached the same conclusion (AL-Ahmed, et al., 1991a) (AL-Ahmed, et al., 1991b) and (Sadik and AL-Kaswana, 1990). Such a power of belief does not mean that the Islamic

religion is an obstacle to development but that it is a way of life which has to be taken into account.

Sutcliffe (1975) found no ground or evidence for the assumptions made by Weber that Islam with its

"thoroughly traditionalistic ethic... directed the conduct of life into paths whose effect was mainly opposite to the methodical control of life found among Puritans" [Weber (1963, p.265) as cited in Sutcliffe, (1975, p.77)].

And McClelland's conclusion in 1961 that **"Arabs as Moslems are probably generally low in achievements"**(McClelland, 1961, p.340 as cited in Sutcliffe,1975, p.77). Although the concept of development itself was simple under the previous two assumptions, the researcher found that **"religious commitment (in the Jordanian Valley) has no statistically significant effect on adoption of modern farm methods or productivity"** (Sutcliffe, 1975, p.80). However, development is not the adoption of modern methods of farming but it is rather the enhancing of entitlements and choices for people to determine their destiny.

These views are shared by a growing number of scholars who believe that traditional values are not inefficient values, particularly in the Islamic context (Reilly and Zangeneh,1990) (Banuri,1990) (Slater,1989) (Choudhury,1990) (Said,1989). This cannot be recognized without combining the space factor in any analysis of a development strategy. It is introducing the place factor, as Barnes and Sheppard (1992) argued, which can explain the rationality of human actions because the latter

"varies systematically and unpredictably according to the context in which the action occurs"(p.18). So, the question is whether or not international organizations such as the World Bank and the IMF take such factors into account when they put forward their policy proposals.

The Jordanian government started its economic reform programme in 1988 by freezing expenditure and subsidies while increasing revenue through new taxes and duties. However, the measures of 1988 failed to bring about a significant reduction in the budgetary deficit. In 1989, the Jordanian government concluded a structural adjustment package with the IMF. The agreement itself represented the first admission by the government that it had mismanaged the economy.

A first condition of the agreement was a cut in government subsidies on fuels and foods in order to reduce the budget deficit (excluding grants) from 23.7 percent of GDP in 1988 to 19.6 percent in 1989. This meant that the measures, although economically sound, were also directed against the interests of the poor. On 16 April the government implemented price increases on a wide variety of goods such as petroleum products (11-33 percent), alcoholic beverages (40-50 percent), and detergents (25 percent). Water charges in the Jordan Valley were also doubled. Moreover, the government on the IMF advice agreed to reduce its subsidies on essential goods such as powdered milk, barley, bran and olive oil by increasing

their retail prices (Satloff, 1992).

As the price burden fell too heavily on low-wage Jordanian workers and small farmers, who had benefited least from the country's boom years in the late 1970s and early 1980s, riots spread from the southern region of the country, which is also the poorest, within hours of the price increases being announced (Guardian, 21st April 1989, p.10).

This shows that neither the authorities nor the IMF had given thought to the effects of such measures on the poor. The demands of the people during their collective action (riots) provided a clear voice against P.M. AL-Rafai's economic reform policies on the one hand and the centralization of decision-making on the other. In relation to Hirschman's (1970) concepts of exit and voice the riots represented the activation of voice when the exit option had achieved its limit.

The first demand of the rioters was for the dismantling of the measures towards cuts in price subsidies; the second was support for small farmers; the third, while pledging loyalty to the King, was a demand for the end of economic inequalities and corruption and greater political freedom and participation (Brynen, 1992, p.90).

Although it is not possible to find a direct causal linkage between privatization and the riots, because no privatization took place, the people's dissatisfaction with the economic reform policies can be understood as a

no vote against privatization as well. This is because the state is the major employer, and a severe cut in its expenditure meant cuts in jobs and a resulting increase in uncertainty, unemployment and poverty.

In such an environment privatization and policies of "getting the price right" and that of functional decentralization cannot secure choices and participation for the people within the context of decentralization as a strategy for development. It simply makes the rich richer and the poor poorer.

Crown Prince Hassan, when asked for his view on the IMF measures after the riots, said "these measures will be more than we can bear unless we can secure Arab aid" (Interview with Crown Prince Hassan, April 23rd, 1989).

However, Satloff (1992) contended that the riots were a result of the lack of consideration given to the effect of such measures by Jordan's decision makers on the poor, especially since the Jordanian team postponed discussions with the IMF on specific policies in order to protect the poor from the above measures. However, a failure to anticipate the outcome of government policies is a culture in Jordan's economic management.

The resulting riots were an opportunity for the people to show the authorities their degree of dissatisfaction with the country's political and economic management, particularly that of Prime Minister AL-Rafai, the organizer and designer of the economic reforms.

In the words of Ian Black, the Guardian's correspondent in

Amman

"He (AL-Rafai) was widely blamed for the effects of the recent agreement on debt rescheduling with the International Monetary Fund, and, more generally, for an arrogant and autocratic style of government that alienated ordinary people struggling with the country's severe economic crisis" (Guardian, 25th April 1989, p.14).

This however indicates another important explanation for AL-Rafai's motive for economic reforms in Jordan, including privatization, namely securing gains for the special distributional interest groups (Guardian, 28th April 1989, p.15)(The Times, 24th April 1989, p.12).

The reaction of the monarch was to dismiss AL-Rafai and appoint a new P.M. critical of AL-Rafai's policies. In addition, the riots represented for some commentators the turning point in the drive towards political liberalization and participation in Jordan. The question, however, is what kind of relationship developed between democracy, participation and privatization (functional decentralization).

7.8: Democracy, Participation, and Privatization

The riots resulting from the country's economic crisis and the government economic reform policies led the monarch to appreciate that political reform was important in order to temper the repercussions of the IMF adjustment Plan (Robins, 1990). Thus, from the preceding discourse, the two main factors which determined the introduction, form and the nature of the democratic process were the short and long-term objectives of political stability and the

economic reform programme which includes privatization. Both have led to greater political freedoms and new political controls.

Our argument is that participation through democracy and pluralism cannot in Jordan be equal to that of popular participation through territorial decentralization because the spatial reversal factor is absent from the first mechanism of participation.

Democracy has been introduced to enable the same economic reform programme to be implemented with parliamentary approval. Even if opposition to economic reform is mounted, parliament will have no alternative but to accept the reforms because that is the only way to ensure that Jordan's debt can be rescheduled and the economy receive additional funds from international aid agencies and western countries which demand reforms as a condition.

The democratization process started in November 1989 with the election of the Chamber of Deputies, but since then the process has been controlled by the authorities in a way consistent with their general aim of political stability and the approval of economic reforms.

The aim of starting the democratic process early could be seen as a way of pre-empting any further violence or rioting in the country.

In April 1990 King Hussein appointed a Royal Commission (R.C.) to draw up a national charter governing the democratization process in the country (Susser, 1993,

p.498).

Rather than relying on the National Assembly to draft the charter the leader through his assignment to the (R.C.) of this very important task determining the future and the form of popular participation in Jordan proved that the process of political liberalization or democratization would be subject to direction from above.

This is consistent with the objective of "keep in control" because the authority saw that the national charter was essential to Jordan's democratic experiment (i.e., define the legal and ideological framework). It also ensured that "the process of liberalization *would not get out of hand and endanger the regime*" (Susser, 1992, p.468). It could be said that it was also a way to escape the danger of the Islamic movement having an influence on the shaping of the charter.

Likewise the P.M., Badran, in 1990, declared that political liberalization in Jordan "was the "real safety valve" for a country in prolonged economic crisis" (ibid). Similarly, the King's adviser, Adnan Abu Awda, noted that the National Assembly should "serve to complement [i.e., not oppose] the state in carrying out its duties" (ibid).

The three above quotations show that the authorities believed they were best placed to define the rules of the game. One result was that ratification of the national charter on 9 June 1991 was carried out by a specially summoned national conference (Susser, 1993, p.501).

The charter was composed of eight sections dealing with different dimensions (e.g., the rationale and aims, the law-abiding state and political pluralism, the economy, society). However, three of them provide an important linkage between democracy, participation and privatization.

The first principle of the charter reserved the right of forming and designing policy ;

"The system of government in the Hashemite Kingdom of Jordan is parliamentary, monarchic and hereditary. Adherence by all to legitimacy and to respect of the letter and spirit of the Constitution shall enhance the union between the people and their leadership" (Ministry of Information, 1991, p.14).

In the section dealing with the principles and limitations governing the political parties the charter withdrew the right to use demonstration and violence thus depoliticizing the issue of economic reforms.

"Jordanians enjoy the right to establish and belong to political parties and grouping provided that their objectives are legitimate, their methods are peaceful and their statutes do not violate the provisions of the Constitution" (ibid, p.21).

Also, in chapter one, the right of the citizens

"to change their circumstances and improve their lot by legal means, express their views, and report to whatever they deem necessary for the benefits of the whole by legitimate methods, and participate in the decision-making process" (ibid, p.13)

Control of the democratization process was necessary but not in itself sufficient to absorb the dissatisfaction with economic management and economic reforms. Therefore, cooptation was another goal for democracy. In other words,

it was an avenue for the political leaders to bring key opposition figures under control (Pool, 1993, p.51). The opposition's acceptance of the rules of the game in itself denoted a major victory for the leaders because it secured the goal of political stability on the one hand and on the other put them on line to share the responsibility for managing the economic crisis and the economic reform programme. Any criticism from the people of the government's economic management implies criticism of Parliament. However, that does not mean Parliament will in practice have the upper hand in managing economic policy.

In summary, a measure of popular participation in difficult decisions about resource allocation was necessary since the authorities had no intention of lifting either the economic reform programme or the austerity measures it implied. In fact, between 1991 and 1992, state subsidies were reduced from 120 MJDs to only 40 MJDs (The Middle East, 1992, p.8).

Regarding privatization and the role of the state chapter 5 of the national charter noted that the future relationship between the state and the private sector should be based on encouraging private ownership. However, the state would retain control over strategic industries as well as regulating the economy.

" The Jordanian economy must be based on respect for private ownership and encouragement of private enterprise. On the other hand, natural resources and strategic projects must be the property of the state, with a full right to their management and supervision in the public interest. The state must also retain the prerogative of regulating the economy and allocating resources in accordance with national priorities" (ibid, pp.26-27).

Thus, the relationship between democracy, participation and economic reforms including privatization was formed in order to serve political stability rather than popular participation.

As Amawi (1992, p.29) argued, democracy in Jordan is limited to the parliament, parties and the press, but it has to include socio-economic rights, such as the right to form grass root organizations (GROs). UNDP (1993, p.21) contended that individuals participate more effectively through group action which comes through membership in community organizations.

Political participation may be secured through democracy, but the latter cannot secure social and cultural participation. Likewise, economic participation through economic reforms and privatization cannot assured social and cultural participation unless privatization design and implementation techniques are well designed.

The question of economic reforms, on the other hand, goes beyond the issue of privatization or public versus private since it belongs to the centralization/decentralization sphere of policy formation. Both processes,

democratization and economic reform including privatization, are state-induced and relatively the state retains a considerable degree of management over them in spite of the fact that "democracy has to be valued and sought for itself, not for its economic rewards" (Harik, 1992, p.22). Although UNDP (1992, p.27) contended that "political freedom is an essential element of human development", it is important that it is understood within its particular applications, objectives and limits.

7.9: The Current Thinking of Decentralization and Development

In Jordan the authority does not want to expand the spectrum of democratization because it can act as a constraint rather than an advantage for proceeding with economic reforms.

A measure of the authority's achievement in democratization is its success in passing the budget and economic reform programme for 1992 through Parliament with a comfortable majority (EIU, 1992b, p.16). The new Parliament elected in November 1993 is expected not only to give decision makers no problems but also to provide good support in implementing the IMF and other long delayed privatization programmes (The Middle East, 1994).

Further important evidence of increased centralization is the shift in planners' and decision-makers' orientation and thought from participation and empowerment within the

context of decentralization and development (i.e., devolution), similar to that in the 1986-1990 development plan, to a more functional decentralization (i.e., deconcentration, delegation and privatization) in the latest five-year development plan (1993-1997).

The word decentralization appeared only three times in the new 196-pages development plan document, published in February 1994. The first objective of decentralization is to increase the efficiency of government administration by reducing intervention and duplication of responsibility between different government departments (Ministry of Planning, 1994, p.86).

The second occasion where the word decentralization appears is in the context of conducting studies of government agencies and departments outside the capital in order that some of the centre's responsibilities can be delegated (ibid, p.129)

The third and last occasion in which decentralization emerges is in the context of increasing the financial and economic efficiency of SOEs. In this episode the decentralization of power to branches of SOEs in the governorates will increase their flexibility and autonomy so that they can increase their degree of responsiveness according to location (ibid, p.128).

In more than one case, the emphasis on privatization as a way of decentralizing decision making to the market place was based on the argument of inefficient and highly centralized SOEs (ibid, pp. 41-42). However, the plan

revealed that the state will continue to control strategic activities within the economy.

In summary, the 1993-1997 development plan represents a clear shift from participation and empowerment (i.e., to territorial units) towards sectoral planning in which the emphasis is mainly concentrated on the limited delegation of power and responsibility within government departments. In this plan there is not even one occasion in which municipality and village councils are mentioned.

That is to say, the relationship between decentralization and development in Jordan is based on development from above in which the central authority determines to what extent participation and empowerment shall be allowed. For that reason we argue that unless privatization can increase participation (i.e., increase employee participation in decision making, increase the number of lower-income shareholders) it cannot achieve a higher level of human development.

The danger comes when IMF policies and privatization programmes deliver no significant outcomes in terms of growth and efficiency, and lead to a deterioration in living standards because of increasing unemployment and poverty.

If privatization is in future to include health, education and other basic needs sectors of the economy, then the human development achievements of Jordan during the last four decades will be thrown away. As table (7.7) asserts,

Jordan's success in human development is visible. The human development index rose from 0.428 in 1970 to 0.586 in 1990 which put the country among the leading nations in terms of human development.

Table 7.7

Comparison Between Trends of Human Development in Jordan with those of Developing Countries

Trends in human development	Jordan	Developing Countries
-Life expectancy at birth (years) 1960-90	46.9 to 66.9 years	46.2 to 62.8 years
-Under five mortality rate (per 1000 live births)1960-90	217 to 52 child	233 to 112 child
-Daily calorie supply (as % of requirements)1965-88	93 to 118 % of requirement	90 to 109 % of requirement
-Adult literacy rate (%) 1970-90	47 to 80 %	46 to 64 %
-Real GDP per capita (PPP\$) 1960-89	1120 to 2415 PPP\$	784 to 2296 PPP\$
-Human development index 1970-1990	0.428 to 0.586	N.A.
-The difference between GNP rank and HDI rank (1989-90)	-13*	N.A.

Source: UNDP (1992, table no.1, pp.128-129 and table no.4, pp. 134-135).

*Shows that the GNP rank is higher than the HDI rank.

The country's position according to the 1992 Human Development Report is 14 out of 110 developing and developed countries listed (UNDP, 1992, table no. 1.3, p.94). However, the high investment in basic needs, particularly health and education, during the 1970s and the beginning of the 1980s was related to increasing external revenues as was the increase in per capita income. Thus, the achievements should be understood within the context of a semi-rentier economy in which dependency on external factors determines the policy direction. If

the Jordanian government is forced to cut expenditure in the future as a result of IMF and World Bank conditions, the targets will be the softest items such as health and education. This represents a risk particularly if the decision makers continue to exercise a top-down approach towards development.

7.10: Important Factors in the Relationship Between Privatization, Decentralization, Participation and Development

The preceding discussion on the relationship between the four issues did not take into account some important factors.

7.10.1: Reforming SOEs

One of the important factors which has to be taken into account is the reform of Jordan's SOEs because, according to the 1993-1997 plan and the 1991 National charter, many of them will continue to operate under state ownership.

1. The first step is to decentralize the authority of such SOEs from the government to their managers so that they can operate with some autonomy. Government intervention in the running of such enterprises has been one of the main factors affecting their performance in Jordan. Multiple objectives and political appointments to the boards of directors have allowed the state to divert the operation of these enterprises to non-economic objectives.

2. Employing a system of performance evaluation which has to be linked with another system of incentives for managers and employees. This contrasts with the present system of routine bonuses for all managers and employees irrespective of their performance. Setting planned targets for the performance of every line and department over a certain period of time are important elements in distinguishing between "efficient" and "inefficient". Such target achievement systems with efficient incentive schemes will allow better prospects for efficiency.

One of the major problems in Jordanian SOEs is the weak system of control which raises the principle-agent problem. As Jones (1991) said, "the [SOE] manager plays a game without a score" (p.6). Introducing an efficient system of performance evaluation with another of incentives will contribute to solving such problems. This is a difficult task to implement. Moreover, such systems require continuous development of the performance indicators themselves.

3. Establishing a new and competent system of accountability which should be linked with an efficient accounting system. Shirly (1990) gave five problems in holding managers accountable;

- 1.The available information does not give a clear and accurate picture of performance.
- 2.There are no standards by which to judge results.
- 3.There is no organization assigned and competent to evaluate performance.
- 4.There are no procedures to follow up on the evaluation.
- 5.The managers face many constraints in how much they can affect performance"(Shirly, 1990, p.28).

The need for monitoring enterprise accounts by an unbiased and competent third party is very important. Thus, if the decentralization procedures are implemented, the government could play the role of the third unbiased agent; otherwise, it is incapable of assuming such a role when it is the suspect and the judiciary at the same time. However, this needs a specification of the enterprise's objectives, commercial and non-commercial, which are quantifiable. In cases where the objectives cannot be quantified, qualitative measurements can be used through weighting their effects on a scale.

Managers should be held accountable for factors within their control, and they should know that their reward or punishment will be according to the behaviour of those variables. In the oft quoted words of Jones;

"If autonomy is to be efficiently and permanently delegated to the enterprises, then accountability must be insured by a signalling system which specifies and rewards socially desirable behaviour" (Jones, 1991, p.9).

4. The dissemination of information through a performance information system. It is the people who should know the details of the enterprise's performance. In any private company, such information is provided to the public or the shareholders in order that they may assess the performance of the company. The same principle could be applied in SOEs. The corruption in many SOEs in Jordan would not have occurred if there had been a regular check on the information provided. This system with the accountability system can provide safeguards for the people.

5. Government representation on the board of directors should be for technical reasons only unless obvious objectives need to be considered and clear reasons can be given to justify breaking such a condition.

6. Any subsidy for the enterprises should be accompanied by an evaluation of the reasons for the subsidy. Such subsidies need to be planned for over a period of time and the public kept informed about them. In Jordan, some subsidies have been necessary as the direct result of deficient government investments. A review of such enterprises and their prospects should be undertaken in order that, through analyzing the different objectives, ways of improving performance can be agreed. In cases where the future prospects of such enterprises, from the social welfare point of view as well as the micro and macro economic and financial dimensions, are severely restricted decision should be taken to liquidate them or to merge them with other enterprises that can benefit from their output.

Any subsidies which occur because of deficiency in performance and as a direct result of management performance, rather than specified exogenous factors outside management control, should be accounted for by its management team.

7. Elected members of outside organizations (private individuals, NGOs, Public organizations, customer

organizations and so forth) should participate in monitoring the quality of performance and report their findings and recommendations through the different channels of information both to the enterprise and to the public. Employing the "double check" principle can help overcome the difficulties of such enterprises. The ordinary people or what is called the "non-expert populace" as Goulet (1989, p.166) described them, can often contribute positively to their evaluation because they are the customers affected by management performance. Employing a system of evaluation from below as well as from above (experts) can coordinate the efforts to improve the enterprise's performance. Open lines for customer complaints and recommendations should allow room for voices to be listened to rather than to be suppressed or avoided as has been the case in Jordanian SOEs.

8. Evaluating the provision of Public enterprise services on a spatial scale, that is to consider the balance in services provision for the poorer local areas against the urban areas and setting time-place targets. This could be achieved through discussion and the coordination of local people particularly in rural areas where participation is minimal.

9. Another problem facing SOEs in Jordan is overstaffing. In this case the government has to take the responsibility of introducing training programmes, which are in short

supply, and redeploying the workers towards the economic sectors with a shortage of employees, in particular the semi-technically skilled.

10. Increasing employee participation in the initiation, planning, implementation and evaluation of the different projects would give them an incentive to reduce shirking and opportunism because participation will set new standards in the work place where every employee will be considered an important member of the enterprise. Currently, the shop floor workers in Jordanian SOEs play no part in decisions regarding the operation of or the investment in their enterprises. That is because of the socio-economic culture which divides the work force into managerial and manual workers where the latter have no say.

7.10.2: Bureaucratic Reforms

Another factor which privatization does not take into account is bureaucratic reform. As a centralized state in which bureaucrats constitute 48 percent of the total work force, there is a need for Jordan to reform its administration. The fifth and the sixth development plans (1986-1990) (1993-1997) respectively describe the overcentralization of authority and its relevant problems by a weakness of commitment towards administrative development leading to a lack of confidence in efforts exerted in this direction.

- Too much centralization in certain agencies, where the agency head becomes the sole decision-maker on most issues, coupled with a responsibility span which is too broad for effective management.
- An indifferent attitude to public relations which takes the principle of reciprocity into account.
- Weakness of the administrative staff in local government organization, procedures, manpower and financial aspects, together with insufficient concern for their development. (Ministry of Planning, 1986) (Ministry of Planning, 1994).

Although bureaucratic reforms have been conducted since the 1960s, this has been a slogan of every government rather than a genuine commitment.

Ellayan (1987) conducted a survey by questioning the heads and permanent secretaries of 76 administration departments who in reality represented the bureaucratic elite. He found that 56 percent of the respondents admitted that their services did not meet people's expectations, and 52 percent said that their departments lacked adequate information systems.

There is, therefore, a need to reform the bureaucratic structure by decentralizing the authority of the central agencies on the one hand and decentralizing their authority to the sub-regional and local levels on the other.

However, this should be accompanied by the introduction of

an efficient accountability system (performance tables) to ensure that the people's views of the services provided by these departments are registered.

Decentralization by itself will not be enough without a change in the rules and legal structures which govern the bureaucratic environment. Training and accountability are important steps in changing the structure of bureaucratic practices. The promotion and stimulation as well as the vitalization of local initiatives will contribute significantly in that direction. This is not a simple task because it requires concrete commitment and changing the rules of the game. However, a journey of 1000 miles has to be started with a first step.

7.10.3: The Informal Sector

While the concern of privatization is the transfer of ownership and/or control from the state to the private arena, its focus has been limited to one sector of the Jordanian economy, namely the formal sector, where SOEs are operating.

The informal manufacturing sector in Jordan denotes 80.8 percent of the total number of manufacturing establishments in Jordan. Thus, competition or contestability is the environment under which such micro-enterprises are operating. While sunk costs in such enterprises are negligible, their survival is determined by government regulations and policies. Privatization proposals in Jordan, as introduced in 1986, did not

discuss the factors affecting the operation of this sector. Neither did the latest development plan (1993-1997).

There is a need to support such micro-enterprises in Jordan through a bottom-up approach. Those micro-enterprises are denied access to credit and financial assistance as well as the appropriate regulations to perform efficiently so as to absorb the problems of unemployment and poverty in Jordan. This is because these enterprises are working on the fringes of the law. Most of them have been consistently discriminated against. They do not have legal protection and often rely on an informal structure and informal contacts with the formal system in order to survive. While they rely on indigenous technology and innovations, which are the basic solutions for curing the illness of modernization, the decision makers and Jordanian experts link them with inefficiency and traditionality which cannot bring about development.

Privatization is one of the policies that can diminish their contribution because privatization is associated with large enterprises and modern technology which is capital intensive. It might be argued that getting the price right will enhance the possibility of bringing in labour intensive technology because of the work of the relative prices mechanism. That probability is so narrow because privatization is always associated with internal and external competition. Relying on distorted labour markets, as is the case in Jordan, with highly educated

people makes the capital intensive alternative more attractive to entrepreneurs. Profitability, efficiency and competition need economies of scale, that is modern technology, and often "master key" projects in the case of Jordan. This relies on the assumption proposed by the proponents of "development from above". That is to say that those large enterprises are "growth poles" to be integrated through linkages with other sectors in the economy. However, that is not the case in Jordan where weak linkages between and within the different economic sectors have been an integral character of the economy in the last three decades.

Privatization seems likely to reinforce the existing conditions (of formal and informal sectors) by focusing policy on the critical needs of the formal sector, which already has access to resources and information as well as the support of government.

Supporting micro-enterprises which enhance self employment is not a trade-off between profits and employment, but rather between private returns and social costs, or between short-term and long-term growth alternatives as Dessing (1990,P.7) argues.

Thus, it could be said that promoting informal activities in Jordan would mean opening the administration gates so that they can gain access to resources and reduce entry and participation costs. That is "crowding-in" the informal sector because markets are restricted in Jordan

to the benefit of the large enterprises in the formal sector. Therefore, eliminating the restrictions (i.e., huge working papers , ministerial approval, and so forth) would enhance the informal sector's capacity to produce and contribute rather than reduce its potential.

The second benefit from expanding the capacity of the informal activities is that they are naturally more responsive and flexible to people's needs and demands. They can reach everywhere whether in urban or rural areas. This could promote a mixture of the "exit" option with the "voice" option. Moreover, they usually rely on personal relations and community communication networks. This can reduce transaction costs within the community.

Many handicraft activities have been eliminated in Jordan because of their inability to compete and gain access to the markets. Two field studies in Jordan found that there would be a high potential for such small-scale industries in rural Jordan if they could gain supportive policies (Sadik and AL-Kasawna,1990) and (AL-Ahmed, et al.,1989). The elimination of such traditional activities was also a result of the commercialization of the agriculture sector, the division of labour and monetization of the economy where the people devalued their traditional businesses in favour of new ones that could generate cash.

Traditional products also faced unequal competition from similar imported goods with cheap origins such as Taiwan and Hong Kong.

There is a need to reshape government policies so as to emphasize the importance of using endogenous and appropriate technologies, which people control rather than being controlled by them. The informal sector is solid ground for such a take-off point.

People have shared their knowledge and experience for generations. The efficiency of their technologies might be unable from the point of view of technical standards to compete with the western technologies, but it is efficient enough to generate and express their values, balance, satisfaction, equity and respect. The latter can ensure their survival as a community rather than as individuals. Privatization and market-oriented policies eliminate such important factors.

7.10.4: Legal Decentralization

In Jordan, there is an excessive centralization of the judiciary, legislation and executive powers in the hands of a few government agencies. Privatization does not eliminate or reduce such powers which have been used discriminately for the benefit of particular interest groups. Moreover, privatization increases these powers enabling the government to conduct its top-down market oriented and privatization remedies.

There is a need to transfer these powers to decentralized units, vertically and horizontally, so that power can be shared rather than concentrated. This requires decentralization to the territorial units as well as

within the bureaucratic structure itself.

The strategy of development from below and within depends primarily on participation. This participation cannot take place if there is no decentralization of the legal system. Many powers in Jordan are concentrated in the prime minister's and ministers' offices. Delays and inefficiency are features of the state system. However, such transfers need a complementary policy of training to enhance the capability and capacity of the decentralized units to work efficiently on the one hand and to prevent them being manipulated by small interests on the other.

7.11: Conclusion

In the last three decades Jordanian decision-makers and planners have tried different approaches towards development. All these approaches were based on development theories which originated in Western countries and were characterised by an emphasis on modernization and growth. However, they were based on a centre-outwards, top-down view of development. As a result, Jordanian policies were based on a vision of imitation and blind emulation of ideas and devices which were not harmonious with people's needs, norms, and values. The poor have been left struggling to survive the high tide of modernization which has left them worse off. As a result, there is a desperate need to find an alternative approach which will enable people to participate and mobilize their underestimated capacity.

The view of international agencies such as the World Bank and the scholars who follow their line of thought is that decentralization and privatization are synonyms. Both can be employed to achieve growth and efficiency and as a result cure the cancer of poverty. Such a view equates privatization with increasing choice and entitlement, participation and empowerment. However, in the case of Jordan the reality is different because it has been found that what people want is participatory development. Privatization, however, would open the door only for the rich to participate and this they are doing even without such policies.

In contrast to the territorial decentralization emphases of the fifth development plan (1986-1990) the examination of the relationship between local village councils and other central government agencies suggested that no such decentralization has taken place. Further, the examination of decentralization ratios before the 1986-1990 plan and during its implementation found that the modified expenditure decentralization ratio (MEDR) dropped on average from 8.3 percent during the period 1980-1984 to an estimated 4.8 percent in 1988. Likewise, the revenue decentralization ratio dropped on average from 5.7 percent during 1980-1984 to an estimated 4.1 percent in 1988. However the measurement of the financial autonomy ratio (FAR) which measures the degree of local government spending control is high in Jordan (on average 99 percent

between 1980-1984); firstly because local government spending is very low and secondly because the measurement of local revenue itself does not discriminate between revenues collected by local authorities and total local revenue which includes transfers from central government as well as other extraordinary revenues (e.g., aid and loans). If such factors are taken into account the FAR in Jordan would be reduced from 104 percent (according to the non-discriminate method of the UNDP) to only 15.5 percent (after revenue discrimination) in 1988.

Further evidence of the inappropriate outcome of the top-down approach to investment at the local level suggested that the allocation of projects through Jordan's Cities and Villages Development Bank was directed away from the basic needs approach to development. The detailed data of allocation notion showed that loans allocated for investment in basic needs were very small (i.e., 1.5% in electricity, 0.5% in schools, and no investment in water, sanitation and health). This result is contradicted by the UNDP (1993, p.74) evaluation of the bank's role.

Privatization is a functional decentralization based on the market. Thus, leasing government land to capitalist farmers, which started before the recent decision in 1991 to lease state lands, led to a more unequal distribution of wealth and income and with it less empowerment to the poor which is the objective of decentralization as a

strategy for development. Furthermore, it led to the exclusion of small farmers from the decision-making process with subsequent negative effects on the development of the agricultural sector in Jordan.

It is often argued in the literature that democracy is an important mechanism for increasing participation. However, in the case of Jordan democratization, which was initiated in 1989 as a response to social dissatisfaction with the economic reform programme enforced by the IMF, has been used not to increase participation but to continue the process of centralization with parliamentary approval. The chapter has provided a set of evidence including the clear shift in emphasis on decentralization derived from a tentative examination of the goals of the more recent five-year development plan 1993-1997. It is suggested that democratization and economic reforms including privatization are state induced and that the state retains a considerable degree of control when managing them.

Moreover, it is suggested that if the scope of privatization is expanded to include the provision of health and education, then Jordan's high achievements in human development during the last three decades, which were mainly the result of large windfall external revenues, may be placed severely at risk.

In its final section, the chapter suggested many factors which are important to the relationship between the four elements; privatization, decentralization, participation

and development. The first is a reform of SOEs in order to make them more efficient and accountable. By setting new standards of evaluation as well as allowing employees more participation and managers more autonomy, reforms may prove to be a better alternative to poorly designed privatization.

Reforming the bureaucratic structure is the second factor. There is a need to decentralize authority from the central to the lower level agencies. This will involve training the newly delegated agencies to be more accountable as they become more autonomous. This in itself requires the establishment of an efficient information system to reflect the voice of the people and their evaluation of the services because bureaucratic reforms have to be understood in the context of making government agencies more accountable to the people and more responsive to their demands.

The third factor which privatization does not take into account is the development of the informal sector. There is a need to support micro-enterprises in Jordan because they constitute the major employer and the provider of income for a large segment of the population. Their low sunk costs make them more open to competition and more flexible in responding to consumer demand. They may appear to be technically inefficient from the modernization point of view, but they are efficient enough to reduce unemployment and provide income if appropriate policies allow them access to the benefits provided to the formal

sector (i.e., credit). Their application to simple and appropriate technology as well as their integration with the local level are advantages not to be found in the modern sector in Jordan.

The last factor of importance is legal decentralization which privatization cannot secure. This requires decentralization to the territorial units as well as within the bureaucratic structure.

In summary the chapter suggested that the relationship between privatization, decentralization, participation, and development in Jordan is more complex than the theoretical analysis suggested. Neither the introduction of democracy nor economic reforms including privatization have secured participation in Jordan. This is because both policies have been initiated, planned, implemented, monitored and evaluated from above. The real need, therefore, is to renew the emphasis on decentralization as a developmental approach in which the devolution of power will enhance the participation, choices, and capabilities of the Jordanian people. This in itself requires institutional building wider than that called for in the implementation of privatization policies.

A self-reliance and basic needs approach through participatory development is more compatible with the poverty problem than privatization because the latter will only serve to marginalize the Jordanian poor in a restricted market.

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Chapter 8

Summary of Conclusions



- 8.1: Conclusions of Part I**
- 8.2: Conclusions of Part II**

8.1: Conclusions of Part I

It has been argued by a number of scholars, particularly those of the Neoclassical Political Economy (NPE) or what is called the New Institutional Economics (NIE), that privatization policies are necessary in order to shrink the governmental apparatus and roll back the boundaries of state responsibility so as to minimize "government failure". The survey in chapter 1, of the literature regarding the role of state in development, revealed that there has been no agreement between economists on this point. However, it is possible that the literature is moving into a cyclical pattern. While the development theories of the 1940s and 1950s favoured an expanded role for the state, the NPE or the NIE, which advocated privatization during the 1970s and 1980s, favoured a minimalist role. The recent literature of the 1990s, however, indicates that a minimalist state cannot provide the conditions required by the neoclassical political economists, particularly since the evidence from East Asian countries regarding the state's role does not support the claims of the NPE scholars. Free market policies, including privatization, appear to have been not the only reason for such success; other interventionist policies have also been required. The focus on "government failure" overlooked "market failure". Both failures, therefore, need to be understood if there is to be a better quality role for the state in development. Such an understanding would necessitate a revitalization in

current development studies of the concepts of linkages and externalities from the high development theory of the 1940s and 1950s.

Given the economic challenges facing decision makers in developing countries it is unlikely that privatization will lead to a universal minimalist role for the state in economic development.

One of the reasons for such a conclusion stems from an analysis of the factors, theoretical and practical, which led to the creation and expansion of State-Owned enterprises (SOEs) in the first place. While the reasons for market failure provided by the theory of public economics, such as the existence of public goods and externalities, economies of scale, information asymmetries, and uncertainty, are still valid for the continuous operation of many public enterprises, the real reasons behind the creation of public enterprises reveal that different countries and regions in developing countries exhibit distinctive characteristics. Thus, privatization through ownership change may overlook the importance of understanding the context of each country individually. This is especially the case where the political, social, historical and economic objectives behind the establishment of public enterprises in a country were particularly complex.

Another consequence of understanding the context of privatization in each country stems from the mixed reports about the successes and failures of public enterprises.

The empirical evidence from the three main regions (Asia, Africa, and Latin America) of the developing countries revealed that public ownership is not synonymous with loss. Some empirical studies also show that although some SOEs were loss makers an examination of their economic efficiency suggests a different assessment. Likewise, it is suggested that profitability does not necessarily equate with economic efficiency.

Thus, it is necessary to understand the reasons behind the failure of public enterprises and employ the option of ownership change through divestiture to increase the efficiency of an enterprise as one among several rather than the only alternative.

The theoretical presumption that private ownership is superior was, where investigated, found to be misleading. While bounded rationality, opportunistic behaviour, and information impactedness are found in both public and private organizations, the level of transaction costs seems to depend on the structure of the organization rather than the type of ownership per se. Similar arguments can be traced in the examination of property rights theory and the principal-agent theory where the existence of an efficient capital market, efficient property rights system, efficient incentive systems, and other ingredients, particularly market structure (i.e., competitiveness), and institutions have a greater impact on efficiency rather than any change in the geometry of ownership.

It is established from the review of the empirical evidence in chapter 3 that there is no clear-cut evidence for the supremacy of private enterprise efficiency. This supports our arguments demonstrating the limited effect of ownership change. The reasons behind privatization in developing countries are not based on absolute confirmation of any of the following factors: private ownership superiority, an over-extended public sector, a positive relationship between privatization and development, or large gains for consumers. Rather the review shows that in a large number of developing countries privatization is initiated because of deep financial crisis derived in particular from the negative impact of public enterprises on the budgetary balance of central government. Another reason is the pressure exercised by international aid agencies, such as the World Bank and the IMF, on those developing countries which relied on them for finance, particularly in Sub-Saharan Africa. This means that the conflicts in government objectives regarding privatization have made economic efficiency subordinate to the goal of reducing the budgetary deficit.

The examination of privatization as functional decentralization reveals an interesting linkage with participation, decentralization, and development. The decentralization of decision-making away from monopolistic centralized bureaucracies and back to the market has

revealed that there is a need to differentiate between the income-centred approach to development advocated by the World Bank and other international aid agencies and the human development approach which based on Sen's concept of capability. The difference lies mainly with the means and ends of development. While the income-centred approach looks exclusively at the investment in human capital (education, health, and nutrition) as a way of increasing income and growth which in turn will reduce poverty, the capability approach regards the public provision of social services as the principal medium for human development (to be free to be well, to live longer, be literate, be healthy, and enjoy a higher quality of life). While privatization advocates argue that privatization will increase choice and participation, the experience of many developing countries has revealed that privatization reduces the concept of "freedom of choice" and "collective choice" to the narrower notion of "individual choice", particularly if pursued as a reaction to financial crisis. Being free means being able to increase the voice option rather than escape through the exit option. Unless the privatization of SOEs is well designed it neither increases choice nor alleviates poverty. On the contrary, it concentrates power in the hands of the market place elite and thus runs counter to the objectives of development defined as a participatory approach to human well-being.

What is needed, therefore, is an approach which will

increase territorial decentralization (devolution) as opposed to functional decentralization (privatization), particularly at the local level. Devolution enhances political participation or democracy as well as economic participation. Through the devolution of power two factors, space and the structure of government, come into play. This neglect can explain why people resist privatization in developing countries since it appears unable to deliver participation and the freedom to increase capability at the local level. Privatization in developing countries can be perceived as another type of top-down approach to development. The factors of initiation, design, purpose, objectives, and implementation rest with the interaction between the central authority and its interest groups in the market place. Thus, its implementation in a large number of cases has led the rich to become richer and the poor poorer.

The examination of the fiscal decentralization ratios in developing countries revealed that privatization policies in many countries such as Chile and Brazil, which are active privatizers, was neither accompanied by further steps towards territorial decentralization (devolution), nor by fiscal decentralization to the local governments.

From another perspective, there is only a slight possibility that privatization, within the context in which it is currently being implemented, will increase technological choice within developing countries or

support a "crowding-in" of the informal sector.

Alternatively, development requires a coordination of effort at the national, regional, and local levels. There is still an active role for the state to play in development but this point of view is contrary to the beliefs of the privatization proponents and in contrast with the traditional centralized role.

Development may mean decentralization and the latter certainly does mean participation, but privatization will not necessarily secure participation. It depends on how it is designed and implemented. Privatization, if it is to be sustainable and people-centred, has to be gradual, relatively crisis-free, untroubled and unenforced, marked by a fusion of collective participation from below (i.e., grass roots) and individual participation in the market place. Such an outcome would depend exclusively on the commitment of the decision makers and their vision of empowering the people.

8.2: Conclusions of Part II

The evaluation of the Jordanian economy during the period 1952-1992 revealed that institutional factors played a major role in the successes and failures of development. As a small country with a traditional merchant business culture the Jordanian economy has been hostage to powerful interest groups which play an important role in shaping the sectoral structure of the economy. Because traders, bankers and middlemen are the powerful interest groups the

economy has been dominated by the services sector. During the 1950s and 1960s ISI policies were forced on the country because of the high transportation costs brought about by the 1948 war with Israel. However, ISI policies during the 1970s and early 1980s became a choice that had negative effects on the small economy. Dependency on external markets to provide inputs and weak linkage between the productive sectors of the economy represented the two main negative results of such an industrial approach. A further negative effect was the deterioration of the agriculture sector which started in the 1960s as a result of inappropriate design in the "land settlement" programme in 1957. This programme was a major factor in the widening of income and wealth distribution within the country.

The evaluation has shown that there are internal constraints on the economy (structural, demographical, and geopolitical). Other constraints are the exogenous variables (Arab aid, worker remittances, oil prices and the spill-over from regional politics).

Because of the major impact of the exogenous factors on the Jordanian economy, it can be described as a semi-rentier economy. Its heavy dependency on unstable and uncontrolled foreign transfers have made the country and its development dependent on and vulnerable to exogenous economic and non-economic factors. The dilemma in development is how to conduct economic policies which suit a particular country's features and capacities. The

Jordanian decision-makers, by contrast, have failed to manage development on such a basis and have utilized external revenues to cover up their mismanagement of the economy.

Although health and educational indicators point to some success in the field of human development, this should be assessed within the context of dependency on external sources of finance on the one hand and the government's distributional role on the other (e.g., 90 percent of total health expenditure in Jordan was directed towards non-primary health care services).

The path of dependency has led to an increase in the economy's external debt of more than twice the GNP. Meanwhile, the country suffers from a high unemployment rate and a real crisis of poverty.

In summary, there is a failure in development. This assessment is based on statistics which reveal declining per capita income, unequal distribution of income, increases in the cost of living, polarization of the economy, and above all the rising proportion of poor people. Poverty in itself means that poor people cannot voice their demands and cannot be free to be capable of being well.

Given such an assessment the neoclassical prescriptions of privatization, liberalization and openness are seriously misguided in that they neglect the major roles of institutions and history.

The role of the state in the Jordanian economy has been

divided into three types: government spending which is high in comparison with other East Asian countries and mainly oriented towards current expenditure; a regulatory role which revealed that the Jordanian state is a mercantile state which, although advocating free market ideology, restricts the market and the initiatives of ordinary private entrepreneurs who lack access to the decision making bodies; government ownership of the means of production is limited but highly important in the decision-making context of mixed enterprises.

Given these state roles in the economy the important conclusion is that the decision making process in Jordan is characterised by over-centralization despite the free market orientation ideology of the state. This is consistent with the thesis conclusion presented in chapter 1.

Consequently, the introduction of the privatization plan in Jordan in 1986 did not represent an ideological shift but was more a result of the economic recession which started in 1983 and deepened after 1985, and budgetary deficit, a debt crisis, the attraction of foreign investment, and the imitation factor.

Further proof of the importance of the above factors lies in the fact that there is no clear-cut evidence that private ownership in Jordan is more efficient than government ownership. This is consistent with the conclusions of chapter 3 of the thesis. The case study of

the Jordan Electricity Authority (JEA) demonstrates that state ownership can be efficient economically if there is a hard budget policy and strict monitoring of corporation expenditure. However, it was found that even with such an approach the losses incurred by the JEA derived from factors outside the control of the enterprise. Government pricing of electricity, devaluation of the Jordanian currency, and the initiation of prestige projects such as the linking of electricity lines with other countries in the region are all factors which increased the losses of JEA. There are, however, many cases in which the public enterprise structure has contributed to a deterioration in the parameters of profitability, but this should by no means be assessed as a sound reason for privatization.

While the factors behind the introduction of privatization in Jordan were strong, they were insufficient to induce the government to start the implementation phase. Obstacles to the privatization of SOEs in Jordan, as the record shows, rested on economic factors (the time needed for the valuation of the enterprises, the need for restructuring the enterprises, the lack of a regulatory capacity, and an inefficient capital market) as well as the non-economic factors in particular those derived from the special characteristics of the state-society relationship.

However, the state, even if the privatization programme were to be implemented in the future, would still retain ownership and/or control of many strategic industries.

This corresponds to the findings in chapter 2, namely that there are many reasons behind the creation of public enterprises which will continue to influence state decisions about their retention. However, what is significant is that privatization in Jordan would also imply the creation of these institutions necessary for better government rather than a simple change of ownership per se. This is so because , because within the *current* institutional setting the state would still retain the power to influence private activities in the same way as it influences the public sector.

One of the interesting findings of chapter 7 is that privatization and decentralization in Jordan were designed in 1986 in a similar context to that conceived by the international aid agencies such as USAID and the World Bank. However, territorial decentralization as a means of increasing empowerment was not the approach conceived by the central authority. Decentralization was seen as a new approach to regional planning. Nevertheless, the implementation of the 1986-1990 plan did not give any powers to the local level and local governments continued to be no more than local administrations. The examination of the relationship between local village councils and other central agencies suggested that no decentralization had taken place. Moreover, the examination of the decentralization ratios before the 1986-1990 plan and during its implementation found the ratios to have

deteriorated.

Further evidence of the inappropriate outcome of the top-down approach to investment at the local level suggested that the allocation of projects through Jordan's Cities and Villages Development Bank was directed away from the basic needs approach to development.

The examination of the relationship between democracy, participation, and privatization suggested that in Jordan democratization, which was initiated in 1989 as a response to social dissatisfaction with the economic reform programme, has been used to achieve two goals, political stability and the implementation of the long-delayed economic reform programme including privatization with parliamentary approval. It is suggested, therefore, that, unless the process of political liberalization becomes able to build democratic grass roots institutions (at the local level), democratization and economic reform, including privatization, will continue to be state induced and the state would retain a considerable degree of control when managing them.

Chapter 7 has provided a set of evidence, including a clear shift in emphasis away from decentralization, which is derived from a tentative examination of the goals of the 1993-1997 development plan. This is consistent with chapter 4's perception of the linkages between privatization, participation, decentralization and development. The emphasis on privatization in the plan led decision makers to shy away from committing themselves to

a participatory approach to development. This is because the design of privatization, as shown by chapter 6, does not articulate the interests of underprivileged groups. It is suggested that, if the scope of privatization is expanded in Jordan to include the provision of health and education, then the country's high achievements in human development during the last three decades may be placed severely at risk.

The thesis suggested that Jordanian decision makers should give further thought to reforming public enterprises, initiating a bureaucratic reform programme, allowing the informal sector to contribute positively to development, and introducing some measure of legal decentralization. These steps towards empowerment should be taken with the aim of increasing the capability of people to participate effectively in their destiny.

A self-reliance and basic-needs approach through participatory development is more compatible with the poverty problem than privatization as functional decentralization because the latter will only marginalize the Jordanian poor in a restricted market.

The conclusions of this study revealed the significance of studying privatization within a holistic methodology. Being a part of a whole system, privatization should be looked at within a package of diversified variables that cover historical, political, social, and economic factors. Such an approach can provide a more solid basis for an

appropriate understanding of the problems and the right methods of solving them. There is a need to move away from the simplistic view that privatization increases efficiency and promotes growth.

There are gainers and losers and there are people who need to increase their voice rather than to continue living in ignorance and isolation. Unequal ownership of property is inconsistent with "equality of opportunity". It is the notion of property rights rather than participation because the scale of the first determines the size and activation of the latter.

The real need, therefore, should be to renew the emphasis on decentralization as a developmental approach in which the devolution of power will enhance the participation, choice, and capabilities of the Jordanian people.

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