Privatization: Eight lessons of experience

Privatization is on the rise. More than 8,500 state-owned enterprises (SOEs) in over 80 countries have been privatized in the past 12 years, 2,000 in countries that borrow from the World Bank — according to recent research by Bank economists Sunita Kikeri, John Nellis, and Mary Shirley.

Not only is the pace of sales accelerating, the size and value of divested firms are also increasing. Close to 30 very large SOEs with a gross value of more than $19 billion have been sold in developing countries in the past two years. Thousands of smaller enterprises are also on the sales block around the world.

It is hard to find a country without a privatization program, or a sector of activity not susceptible to private management if not ownership. Malaysia has sold its National Lottery, Buenos Aires its zoo, Czechoslovakia the guest house of the Communist Party.

Ownership matters

Why privatize? Because ownership is a significant determinant of enterprise performance. In both developed and developing countries, good SOE performance has been very difficult to bring about — and even harder to sustain. Governments facing financial crisis often try to improve performance by bringing in new and dynamic managers, and paying them incentive salaries. And they grant managers autonomy to set prices and hire and fire — and agree to overdue tariff increases and payment of past due bills. These measures often have a positive effect. But as the crisis dissipates, so does political resolve.

Political interference, a common and deadly disease of SOEs, tends to re-emerge — and painfully

Count your blessings

Privatization gains and losses*

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<thead>
<tr>
<th>Country</th>
<th>Enterprise</th>
<th>Domestic</th>
<th>Foreign</th>
<th>Total Gains</th>
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*Annual welfare gain as percentage of annual sales in last year before privatization.
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The World Bank Policy Research Bulletin is published five times a year by the Research Advisory Staff. Subscriptions to the Bulletin are complimentary and may be ordered by contacting Evelyn Alfaro at the Bank’s main address, room S3-127. The Bulletin’s purpose is to inform the development community of the Bank’s policy and research output. It includes descriptions of Bank publications, research summaries, and updates of events in and outside the Bank. The views and interpretations in articles published are those of the authors and do not necessarily represent the views and policies of the World Bank or of its Executive Directors or the countries they represent. The Bulletin is not copyrighted, and it may be reproduced with the appropriate source attribution. For more information, contact Evelyn Alfaro, the production manager. Alison Strong is the editor.
Most privatization success stories come from high-income and middle-income countries. Privatization is easier to launch and more likely to produce positive results when the company operates in a competitive market, and when the country has a market-friendly policy environment and a good capacity to regulate. The poorer the country, the longer the odds against privatization producing its anticipated benefits, and the more difficult the process of preparing the terrain for sale.

Nonetheless, successes can be found in low-income countries, too. Privatization turned around an almost moribund textile firm in Niger, helped revive a defunct development finance corporation in Swaziland, and revitalized an agro-industrial firm in Mozambique. The Mozambican firm diversified into new products, began servicing its debts, and increased production fivefold.

The conclusion is straightforward: privatization, when done right, works well.

**How to do it right**

There are eight key lessons.

1. **Privatization works best when it’s part of a larger program of reforms promoting efficiency.** Chile, Mexico, New Zealand, and the United Kingdom are all successful privatizers. Their privatizations were accompanied by reforms to open markets, remove price and exchange rate distortions, and encourage the development of the private sector through free entry. Revenue maximization should not be the primary goal of privatization. Far better to eliminate monopoly power and unleash potentially competitive activities than to boost the sales price by divesting into protected markets. Also far better to create regulations to protect consumer welfare than to maximize price by selling into an unregulated market.

2. **Regulation is critical to the successful privatization of monopolies.** In the sale of Chile Telecom, everybody won — consumers, labor, government, buyers — and the productive efficiency of the company increased as a result of a well-developed, well-administered regulatory framework.

3. **Countries can benefit from privatizing management without privatizing the ownership of assets.** Management contracts, leases, and concessions have been successfully used the world over, particularly in sectors where it is difficult to attract private investors. In Côte d’Ivoire, the leased water company improved technical efficiency, increased new connections, became more efficient in billing and collection of receivables — and reduced the number of expatriate employees by 70 percent. But because a change in ownership is usually needed to lock in performance gains, private management arrangements are likely to work best when they are a step toward full privatization.

4. **The sale of large enterprises requires considerable preparation.** Successful privatizations of large enterprises have entailed breaking them into competitive and marketable units (in Argentina, east Germany, and Mexico), bringing in dynamic private sector managers (in many telecom and airline sales around the world), settling past liabilities, and shedding excess labor (in steel and railways in Argentina). Successful privatizing governments also assiduously avoided large new investments for plant modernization and equipment, since getting the private sector to finance and manage these investments was itself a major reason for privatization.

5. **Transparency is critical for economic and political success.** Mexico and the Philippines made the sale of
enterprises transparent by adopting competitive bidding procedures, developing objective criteria for selecting bids, and creating a clear focal point with minimal bureaucracy to monitor the overall program. A lack of transparency can result in political backlash, as in the early days of privatization in Poland, or even bring the process to a halt, as in Guinea.

6. Governments must pay special attention to developing a social safety net. In Tunisia, generous severance packages encouraged voluntary departures and reduced the need for outright dismissals. In many countries — most recently in Eastern Europe and Central Asia — employee ownership schemes, unemployment benefits, and retraining-redeployment programs are being developed to ease the social costs of privatization.

7. The formerly socialist economies should privatize in all possible ways that encourage competition, and they should experiment with all available methods that go beyond a case-by-case approach to privatization. Since the economic and social importance of SOEs is far greater than in the rest of the world, flexibility is in order — not because privatization is less necessary, but because it is more so. Rampant institutional and policy deficiencies require experimentation with a wide set of privatization tactics. These include share give-aways (or mass privatization schemes), state-assisted financing methods, free or low-cost shares to employees in privatized firms, and new types of investment-management companies to run groups of companies and diversify risk.

8. In changing the public-private mix in any type of economy, privatization will sometimes be less important than the emergence of new private business. Countries can freeze or restrain the expansion of public enterprises and encourage the growth of a dynamic private sector through free entry, as happened in Korea and appears to be happening in China.

So...

Privatization is not a blanket solution for the problems of poorly performing SOEs. It cannot in and of itself make up totally for lack of competition, for weak capital markets, or for the absence of an appropriate regulatory framework. But where the market is basically competitive, or when a modicum of regulatory capacity is present, private ownership yields substantial benefits.

New Research

The research projects described here have been approved by the Research Committee and are funded by the Bank’s Central Research Budget (RSB). Bank units contribute their staff time to these projects, and RSB funding complements this by providing for expenses such as consultants, data collection, and travel. For information on funding to prepare research proposals approved since May, see page 9.

For information about research projects listed here, contact the researchers at the Bank’s main address.

Research Starts

Services as a Major Source of Growth in the Former Soviet States
Martha de Melo, William Easterly, and Gur Ofer
Country Economics Department, Transition and Macro-Adjustment Division
Ref. no. 677-43

Services have played an increasingly strong role in developed market economies, reaching two-thirds of GNP in some countries. They have played a smaller role in the former Soviet states, which are undergoing a general contraction in output and employment. Business and consumer services are of particular interest, as they are an important factor in improving static and dynamic efficiency, enhancing the quality of life, generating jobs, and providing good opportunities for the expansion of the private sector — through joint ventures as well as wholly owned domestic companies.

The purpose of this research is to estimate the potential contribution of services to economic growth in the former Soviet states, by identifying the gap between the expected and actual levels of service activities there and by looking at the growth in services in other socialist countries in transition.

Drawing on international cross-country, time-series data sets, the research will first undertake a comparative analysis of the importance of services at different levels of development. Services will be measured by value added, employment, compensation of employees, investment, and household consumption; proxy indicators and
GNP per capita will be used for the level of development. Services will be broken down into three subsectors: infrastructure services (transport, housing, communication), public services (health, education, public administration), and business and consumer services (all other services). Business and consumer services will receive particular emphasis.

Historical data on services in the former USSR will be used to explore differences in the level of services among the former Soviet states in recent years. This quantitative analysis will be complemented by a qualitative analysis of the evolution of services — especially business and consumer services — since 1985 in the former Soviet states and in other socialist countries in transition.

With a look toward the future, the research will simulate the potential contribution of services to future value added, employment, and household consumption, and identify a policy agenda to facilitate the rapid expansion of services.

The proportion of elderly in the population is large and growing in many countries. This group, often poor, poses a huge fiscal burden for industrial countries, and may soon depend on the policies they choose. Policies with regard to income security for old age can have important implications for the labor and capital markets, the growth potential and fiscal stability, even the family systems in developing countries. The problem of old-age security has been growing because of the demographic transition and the breakdown of close-knit family structures and of traditional means of old-age support.

This study is designed to help countries reevaluate their old policies and formulate new policies to provide income security for the elderly. The study will first survey the kinds of formal and informal arrangements existing in both industrial and developing countries. It will look at how they work and what their effects are. It will examine the problems that have arisen in these arrangements and present some alternative solutions to these problems.

The study will examine issues related to the transition from
informal to formal mechanisms for handling savings, insurance, and redistribution in developing countries. It will look at how formal mechanisms should be introduced so as to avoid crowding out informal mechanisms. And it will examine differences between pay-as-you-go and fully or largely funded schemes, and difficulties in the transition from the first to the second. The study will examine ways of handling problems caused by inflation and demographic change, and perform simulations of different outcomes based on different demographic and economic assumptions. The study will give special attention to old-age security systems in Eastern Europe and the republics of the former USSR, looking at the kind of systems these states had under socialism, how their transition to a market-based economy is affecting these programs, and how income security programs affect the transition.

Finally, the study will compare the different programs' distributional and insurance effects, their effects on labor and capital markets, and their fiscal, informational, and regulatory requirements. The results of the study will be used to produce policy recommendations. RSB support: $100,000 Staff weeks: 100

Household Welfare Effects of Agricultural Policy Reform in Malawi
Jay de Beyer
Southern Africa Department, Population and Human Resources Operations Division Ref. no. 677-46

Over the past decade many Sub-Saharan African countries have undertaken policy reforms and structural adjustment programs. This research project seeks to shed light on how structural adjustment and agricultural policy changes affect household welfare in the short term.

The research will look at how the liberalization of grain marketing in Malawi in 1987 affected income distribution, food consumption, and the welfare of economically vulnerable groups. The distribution of the costs and benefits of the reform will be investigated through statistical analysis of the determinants of two classes of dependent variables: household consumption, especially of food, and anthropometric measures of children under six and of their mothers. The study will also investigate whether gender plays any role in the effects of the policy change.

The research will be based on the results of a survey of smallholders in a rural district of Malawi. The survey was undertaken in two rounds, in 1986-87 and 1990-91, that bracket the liberalization of grain marketing in the country. It gathered detailed information for a sample of 200 households on seasonal fluctuations in agricultural production, income, expenditures, and time allocation for economically active household members; the structure, assets, and cropping patterns of each household; and anthropometric measures and morbidity of mothers and preschool children.

Food security has been relatively good in Malawi in recent decades, but malnutrition is nevertheless widespread, and purchasing power remains low. It is particularly important in a country such as this to assess the distributional effects of policy change on rural families and to identify the determinants of improvements in purchasing power, food security, and nutritional status.

RSB support: $87,000 Staff weeks: 2

Many countries have experienced improvements in measures of the health status and educational attainments of their populations in recent decades. How much of the improvement can be attributed to economic growth alone, and how much to policy measures? And among policy measures, what are the relative effects of different interventions? Health and education expenditures sometimes provide truly public goods or are directed at correcting standard market failures, but sometimes they provide services that are basically private.

This research project is designed to explore these issues by examining, in a number of countries, the relative effect of different policies that influence health status and educational attainment. The working hypothesis of the research is that policies and services that provide public goods and correct market failures will have a greater effect on outcome indicators than those that primarily substitute for private goods. The research will collect panel data — time-series data by province or region — for a variety of countries to test this hypothesis.

For the health sector, the analysis will explain infant mortality rates (and mortality rates for the population as a whole, where data are available) by income, the proportion of the population with safe
water, the proportion of the population covered by basic immunizations, and available measures of public curative care effort. And it will note patterns in the types of policy that appear to make a difference to health in different contexts.

For the education sector, the research will, first, investigate how the allocation of public education resources among different levels affects basic outcomes (such as enrollment ratios and graduation rates). Second, if data permit, the study will analyze these outcomes separately for different income groups to investigate the distributional effects of different spending policies. Finally, the study will look at the issue of shifting public resources from one level to another. Are there tradeoffs between spending on different levels and inputs, or do spending levels tend to move independently? Have reductions in resources at one level been matched by increases at other levels? If data permit, the study will investigate whether less public spending at higher levels has attracted more private spending and permitted a larger allocation of public resources to lower levels, and what the effect of this public-private mix has been on educational outcomes.

The Housing Indicators Program was created to provide a more solid basis for housing policy in developing countries. The program has three main objectives: (1) to provide a comprehensive policy-sensitive framework for monitoring the performance of the housing sector; (2) to illustrate the importance of good housing policies by providing new empirical information on the relations between housing policies, housing sector outcomes, and broader socio-economic outcomes; and (3) to initiate new institutional relationships that will foster the adoption of improved strategies for formulating and implementing housing policy.

The program has conducted an extensive housing survey in a major city of each of 52 countries, both developing and industrial, and an intensive survey in Hungary and the Philippines. The extensive survey was designed to provide an overview of the performance of the housing sector in each city, including the affordability and quality of housing, housing production and subsidies, and the workings of the regulatory and institutional environment.

This research project will analyze the data collected in the extensive survey in a comparative framework with the goal of contributing important empirical information to governments and to donor agencies engaged in formulating and implementing housing policy. The analysis will, first, establish key empirical relations between levels of economic development and housing sector performance and obtain descriptive norms for housing sector performance, and, second, measure the effects of policies on housing sector outcomes. The project will also identify typologies that can be used to classify countries according to aspects of their housing sector profiles. These will permit analysts to group countries into types requiring different policy packages or instruments.

The project also seeks to work toward the regular collection and publication of housing data on a global scale. Toward this end, the project will narrow the large number of indicators used in the surveys to a basic set of housing indicators that could best characterize housing sector performance.

RSB support: $40,000
Staff weeks: 9

Analysis of the Results from the Extensive Survey of Housing Indicators in 52 Countries
Stephen K. Maya
Infrastructure and Urban Development Department,
Office of the Director
Ref: no. 677-48

The Housing Indicators Program was created to provide a more solid basis for housing policy in developing countries. The program has three main objectives: (1) to provide a comprehensive policy-sensitive framework for monitoring the performance of the housing sector; (2) to illustrate the importance of good housing policies by providing new empirical information on the relations between housing policies, housing sector outcomes, and broader socio-economic outcomes; and (3) to initiate new institutional relationships that will foster the adoption of improved strategies for formulating and implementing housing policy.

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RSB support: $40,000
Staff weeks: 9

Income Distribution, Fiscal Policy, Political Instability, and Growth
Shanta Devarajan and Alberto Alesina
Country Economics Department,
Public Economics Division
Ref. no. 677-49

This research project will investigate theoretically and empirically, in a large sample of countries, the relationships among income distribution, the social demand for redistributive fiscal policies, and long-run economic growth. The underlying premise is that a very unequal pretax distribution of income and wealth in a society will lead to political pressure to redistribute resources. This may have two consequences: first, social unrest and political instability, and, second, the adoption of redistributive transfer programs.

Both political instability and redistributive taxation may have negative consequences for savings, capital accumulation, and growth. Furthermore, the relations between income distribution, political instability, and growth may vary at different stages of development. A central element of the research problem will be the joint endogeneity of these three variables.

RSB support: $10,000
Staff weeks: 6
A question of central interest to the World Bank’s operational work and policy advice is this: When does economic growth become self-sustaining? That is, when does growth provide positive feedbacks to generate continued growth? Much work has emphasized the importance of providing firms with the right incentives and price signals to allow economically efficient decisions. Recent analysis reminds us that investment in physical capital and knowledge-generating activities, inflows of high-quality international knowledge, and self-sustaining agglomeration effects have a powerful impact on growth.

Unlike most earlier studies of determinants of growth, which have typically been conducted at aggregate levels using national or regional data, this research project will look at regional growth from the perspective of firms. It will use the results of a firm-level survey to map agglomeration effects and flows of knowledge and identify the leverage points at which these long-run drivers of growth can be influenced. The survey will cover 360 firms in Southern China and 60 firms in Northern Mexico, two of the fastest growing regions in the developing world. The study will also use published regional data to conduct a more conventional investigation.

The survey data will be analyzed using two forms of analysis. First, narrative analysis will be used to describe and analyze firms’ strategies with regard to product differentiation, the functioning of the local labor and material inputs market, perceptions of firms on the relative performance of different agglomeration economies, and the relative importance and effectiveness of different forms of international knowledge flows. Second, the data will be used to estimate reduced-form equations on the determinants of growth and investment (in equipment and training), explicitly accounting for local agglomeration effects as perceived by the firm and the flow of international knowledge in its various forms. RSB support: $123,000 Staff weeks: 28

The droughts to which many agricultural regions in the developing world are periodically subjected can have devastating effects on household incomes and consumption, especially for the poor. To protect their consumption against drought risks, rural households use a variety of risk management strategies. These are mainly of two types: those intended primarily to reduce income losses in drought years — such as income diversification and seasonal migration for employment — and those that are essentially coping devices designed to protect consumption once income losses have been incurred — such as selling assets, drawing down food stocks, participating in government relief programs, and borrowing from local stores and money lenders.

An important limitation of many traditional risk management strategies stems from the covariant nature of drought risks — most households within a region suffer losses simultaneously. This reduces the ability to pool risks within a region, and makes traditional strategies less effective and more costly. Formal credit and insurance institutions can pool risks across large and diversified portfolios and, in principle, offer an efficient way of overcoming covariance problems and reducing the cost of risk management. But such institutions are rarely well developed in drought-prone regions of the developing world.

This research project will seek to determine the latent demand for improved credit and insurance for better managing drought risks in regions in Burkina Faso and South India. Using household survey data from those regions for drought and nondrought years, it will try to determine how much improved formal sector insurance and credit different types of rural households would be willing to buy at full cost.

First, the study will examine the variation in the response of households to drought, focusing on the types of risk management strategy used by different types of household, and the extent to which households are successful in buffering income and consumption losses during droughts. Second, the study will model household decisions to measure the costs and benefits to household welfare of individual risk management strategies, and to quantify their contribution to coping with drought. Finally, the study will use the model to derive the latent demand for improved credit and insurance instruments. RSB support: $98,273 Staff weeks: 24
A recurrent question in both development theory and policy is this: How much does nutritional and health status influence labor productivity — and thus income — in developing economies? Answering this question convincingly requires isolating one link in a potentially complex and dynamic interrelationship among nutritional status, sickness, and productivity. Longitudinal data sets, based on repeated surveys of individuals over an extended period, offer one way of isolating such a link.

This research project will address the question using longitudinal data from Rwanda collected during 1982-83. First, it will quantify the effects of household incomes and other socioeconomic characteristics on the nutritional intake of children and adults in a sample of households. Second, it will model the interrelationships between nutritional intakes, anthropometric measures, and spells of morbidity separately for children and adults within a system of dynamic simultaneous equations. And finally, it will examine the effects of nutrition, morbidity, and the socioeconomic environment on the productivity of adults.

The parameters that result from the modeling of the determinants of adult productivity will be used in simulations to investigate the effects of different policy options affecting health and nutritional status. Policy options would include provision of subsidized food, additional health care facilities, improvements in sanitation facilities and the quality of water, and increased education of females.

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Books

Historically Planned Economies: A Guide to the Data
Paul Marer, Janos Aron, John O'Connor, Martin Schrenk, and Daniel Swanson
260 pages/Order Stock #12147/$24.95

As more governments with a legacy of central planning move toward the market system, policymakers and others increasingly want to know how well these centrally planned economies have worked. This book is a critical guide to social and economic data on historically planned economies. It shows how such data are generated, how these economies work, and how moving to the market system affects the collection and interpretation of data.

Comprehensive tables compare 17 historically planned economies to 35 other economies — both by country and by income group. These tables provide estimates of the performance of historically planned economies using such market-system indicators as per capita income and gross domestic product.

Researchers discuss economic issues that are unique to historically planned economies and examine data adjustments and interpretations by national authorities and outside experts.
Policy and Research Series

21 — European Integration and Trade with the Developing World
Gerhard Pohl and Piritta Sorsa
95 pages/Order Stock #12204/$7.95

European economic integration is proving to be good for most developing countries. Overall, the creation of the European Community has imparted a liberalizing trend to the trade policies of most of its members, by lowering tariffs and reducing nontariff barriers. The single market project, initiated in 1985, will complete the process of market integration for most goods and services.

This paper examines ways in which the European Community's trade partners, especially developing countries, have been affected by European integration. It reviews past integration experiences, among which moves toward strengthened integration have generally been accompanied by reductions in external trade barriers. And it reviews recent integration plans, which include the single market project and new agreements with both Eastern and Western European countries.

The paper discusses why market unification will improve external access, increase import demand, and raise EC incomes. It also examines why higher growth should check protectionist pressures within the European Community, what would have happened without integration, and which developing countries will benefit most from East-West integration. And it details conditions necessary for ensuring that developing countries benefit from the EC's integration plans; these include continued political stability in Eastern Europe and the republics of the former USSR, and a successful conclusion of the Uruguay Round.

22 — Adjustment Lending and Mobilization of Private and Public Resources for Growth
Country Economics Department
109 pages/Order Stock #12208/$7.95

This third report on adjustment lending is organized around systematic comparisons among three groups of countries: those that received a substantial amount of adjustment lending during the 1980s, those that received some adjustment lending, and those that received no adjustment lending.

The report's analysis resulted in several findings. First, adjustment lending is usually associated with a recovery in growth rates. Second, adjustment lending is also associated with improved policies. Third, the adjustment process generally takes years, and there can be significant costs in the transition. Fourth, adjustment policies help most of the poor, but recessions associated with adjustment often cause temporary declines in welfare for some of them. Fifth, private investment eventually recovers where policy conditions are good, but it remains a problem in low-income countries. And finally, there has been substantial overall public sector adjustment, but misallocation of public sector resources remains a problem.

Based on these findings, the report makes several recommendations for future Bank lending for adjustment:

- Stay the course on macroeconomic and pricing reform.
- Take a broad view of constraints on the private sector and increase attention to "second generation" policies to support the business environment.
- Increase attention to the allocation of public sector resources.
- Reinforce efforts to design adjustment policy programs to promote poverty-reducing growth.
Journals

The articles summarized in this Journals section appear in the September issue of the World Bank Economic Review. Subscription to the Review is available without charge to readers with mailing addresses in countries that are not members of the OECD but are members of the World Bank. Other subscription requests should be directed to the World Bank Publications Sales Unit, Department PR, 1818 H Street, NW, Washington, DC 20433.

Measuring the Independence of Central Banks and Its Effect on Policy Outcomes
Alex Cukierman, Steven B. Webb, and Bilin Neyapti

Making the central bank an agency with the mandate and reputation for maintaining price stability is a means by which a government can choose the strength of its commitment to price stability. This article develops four measures of central bank independence and explores their relation with inflation outcomes. An aggregate legal index is developed for four decades in 72 countries. Three indicators of actual independence are developed: the rate of turnover of central bank governors, an index based on a questionnaire answered by specialists in 23 countries, and an aggregation of the legal index and the rate of turnover.

Legal independence is inversely related to inflation in industrial, but not in developing, countries. In developing countries the actual frequency of change of the chief executive officer of the bank is a better proxy for central bank independence. An inflation-based index of overall central bank independence contributes significantly to explaining cross-country variations in the rate of inflation.

On the Transmission of World Agricultural Prices
Yair Mundlak and Donald F. Larson

This article asks two questions about the relationship between domestic prices and world prices of agricultural commodities: are variations in world prices transmitted to domestic prices, and do these variations in world prices constitute an important component of variations in domestic prices? Domestic prices are regressed on world prices in various forms, taking into account the possible effects of exchange rates and inflation. The empirical analysis is based on data from the Food and Agriculture Organization of the United Nations for 58 countries for 1968-78 and for the countries of the European Community for 1961-85. The results show that most of the variations in world prices are transmitted and that they constitute the dominant component in the variations of domestic prices.

How Small Enterprises in Ghana Have Responded to Adjustment
William F. Steel and Leila M. Webster

Monitoring of adjustment has focused on larger, often state-owned enterprises, many of which have been adversely affected by the more competitive environment. Little is known, however, about the impact of adjustment policies on small firms. Firm-level data from Ghana show that the adjustment process was well under way across sectors and within firms and that new investment was taking place. The adjustment process had strained most firms' operations — profits were squeezed between rising input costs and weak domestic demand and low-cost competing imports. Small-scale industries were forced to become more competitive to survive. Interviews with owners of small firms revealed considerable entrepreneurial initiative in changing product mix and seeking newly opened market niches. Sample entrepreneurs fell into two broad groups: dynamic, successful adapters with good prospects (found mostly among small-scale enterprises) and stagnant producers who had not adapted to the new competitive environment (found mostly among microenterprises). For potentially dynamic small firms, the most critical constraint was lack of access to finance for working capital and new investment. Many micro-entrepreneurs were seriously constrained by a lack of purchasing power among the lower-income population and by saturation of the sector.

The Dynamics of Optimal Gradual Stabilizations
Alex Cukierman and Nissan Liviatan

Inflation inertia may be quite tenacious because of the simultaneous interaction between policy actions and inflationary expectations under imperfect credibility. This result is particularly relevant for understanding some of the failed efforts to stabilize inflation in South America. This article deals with the issue of inertia in the framework of imperfect information about the type of the policymaker and extends the existing models to an infinite horizon. Because policymakers do not have perfect control of inflation, a "frivolous stabilizer" may deviate from the policies of a "serious stabilizer" without necessarily being unmasked immediately. When the difference in the ability of "strong" and "weak" policymakers to...
to control inflation is large, unexpected inflation may be persistently negative for quite a while, thus causing reduced economic activity and giving the indication that credibility is low. If the policymaker persists with the stabilization, this pattern gradually disappears as his reputation rises. But before this final stage the serious policymaker has to compromise his inflation objective in view of adverse expectations about his type and pay the cost of imperfect credibility.

Uniform Commercial Policy, Illegal Trade, and the Real Exchange Rate: A Theoretical Analysis
Stephen A. O'Connell
Countries on fixed exchange rates sometimes use uniform tariff cum subsidy (UTCS) schemes as a way of achieving a real depreciation without disturbing the nominal exchange rate. A potential drawback of this policy in relation to an across-the-board devaluation is that a UTCS scheme provides incentives for illegal trade. Using an optimizing model with currency convertibility and illegal trade, the author finds that welfare is lower under a UTCS scheme than under a corresponding across-the-board devaluation and that in some cases the real exchange rate actually appreciates in response to an increase in the UTCS rate.

Maize and the Free Trade Agreement between Mexico and the United States
Santiago Levy and Sweder van Wijnbergen
Setting the price of maize in rural Mexico above the world price is inefficient and likely to have negative distributional effects because many subsistence producers, and all landless workers, are net buyers; in fact it screens out the relatively poor rather than the relatively rich. The policy objective, therefore, should be to move toward free trade. This would yield large gains in efficiency.

The Free Trade Agreement provides an ideal opportunity to pursue this objective. It will provide freer entrance into the United States for other agricultural products as well as for a broad range of manufactured products. Insuring secure and sustained access for labor-intensive agricultural and manufactured products can help ease the impact on the labor market of a transition away from subsistence maize cultivation.

Household Saving in Developing Countries: First Cross-Country Evidence
Klaus Schmidt-Hebbel, Steven B. Webb, and Giancarlo Corsetti
Although most studies have relied on domestic or private sector saving data, this article uses household data available from the U.N. System of National Accounts for a sample of 10 countries. Household saving functions are estimated using combined time-series and cross-country observations to test households' responses to income and growth, rates of return, monetary wealth, foreign saving, and demographic variables. The results show that income and wealth variables affect saving strongly and in ways consistent with standard theories. Inflation and the interest rate do not show clear effects on saving, which is also consistent with their theoretical ambiguity. Foreign saving and monetary assets have strong negative effects on household saving, which suggests the importance of liquidity constraints and monetary wealth in developing countries.
To make the most accurate predictions, fertilizer specialists and others base their demand projections on a broad range of methodologies and economic factors. This comprehensive analysis covers recent political and economic changes — especially those in Eastern Europe and the former USSR.

The Industry Fertilizer Working Group represents the varied interests of industry, technology, production, marketing, and agriculture. Because the Working Group takes all views into account, its regional and global forecasts represent an objective consensus of all concerned.

Issues for Infrastructure Management in the 1990s
Arturo Israel
World Bank Discussion Paper 171
112 pages/Order Stock #12193/$7.95
Despite progress made by many governments in developing countries, most national infrastructures still provide unproductive, costly services. But infrastructure services can be greatly improved with policies that make such services more accountable to market demands.

This paper analyzes policies that can make infrastructure services more efficient and reliable. The policies cover services for irrigation, transport, telecommunications, electric power, and water and sanitation.

The report examines the potential role of competitive markets and the private sector in providing infrastructure services. It offers advice on how the private sector can finance such operations, and on how governments can increase the productivity of services that must remain in the public sector.

Whether they are provided publicly or privately, infrastructure services in developing countries must be reliable to meet the growing needs of modern international trade. The author provides practical advice about implementing policies intended to make infrastructure services more dependable in developing countries.

Trends in Agricultural Diversification: Regional Perspectives
Shateki Barghouti, Lisa Garbus, and Dina Umali
World Bank Technical Paper 180
223 pages/Order Stock #12191/$11.95
Agricultural diversification is fast becoming a key strategy to promote agricultural development. Diversifying can minimize production risks, increase agricultural productivity, and maintain or improve farm incomes.

This publication presents the results of studies on agricultural diversification commissioned by the Bank’s Agriculture and Rural Development Department. It examines diversification in a regional context, highlighting those areas in Southeast Asia that have achieved notable agricultural diversity.

Some studies describe the status of agricultural diversification and its potential in the rice-based systems of Southeast Asia, especially Indonesia, Malaysia, the Philippines, and Thailand. Others focus on ways to make agricultural systems more flexible in Central America, Sub-Saharan Africa, South America’s Pacific rim countries, and the Middle East and North Africa.

Technical, economic, institutional, and policy issues concerning diversification are examined. These issues include the local adjustment constraints farmers experience and the national policy responses to those constraints.

The papers highlight a problem shared by each region: the limited flexibility of agricultural systems in adjusting to economic, political, and technological change. Analysts discuss how this keeps farmers from adjusting fully to new opportunities that could maximize benefits and minimize risks.
Policy Research Working Papers

Working Papers disseminate the findings of work in progress and encourage the exchange of ideas among Bank staff and all others interested in development issues.

Understanding the Investment Cycle in Adjustment Programs: Evidence from Reforming Economies
Andrés Solimano
WPS919 • Contact Lanha Ly, room N10-063, tel. 202-473-7754.

The Women's Development Program in Rajasthan: A Case Study in Group Formation for Women's Development
Maitreyi Das
WPS918 • Contact Dawn Ballantyne, room N9-059, tel. 202-473-7664.

Trade Policy and Exchange Rate Issues in the Former Soviet Union
W. Max Corden
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Marc Chesney and Jacques Morisset
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WPS915 • Contact Maureen Colinet, room N9-043, tel. 202-473-7754.

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Maureen A. Lewis, Margaret B. Sulzetta, and Gerard M. LaForgia

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November


2-6 — United Nations University International Conference on Sustainable Environmental and Resource Management Futures for Sub-Saharan Africa, Accra, Ghana [Contact: Dr. Juha Uitto, United Nations University, Tohoseimei Building, 15-1 Shibuya-2-chome, Tokyo 150, Japan, tel. +81 3 3499 2811, fax +81 3 3499 2828]


December

1-3 — International Conference on Women and the Environment, High Institute for Public Health, Alexandria, Egypt [Contact: Samia Galal Saad, Department of Environmental Health, HIPH, 165 El-Horriya Avenue, Alexandria, Egypt, tel. 20-3-421-5575/6, fax 421-8436.

3-5 — Fourth Meeting of Global Environment Facility Participants, Abidjan, Côte d’Ivoire [Contact: Nicholas van Praag, World Bank, 1818 H Street, NW, room S5-035, Washington, DC 20433, tel. 202-473-5102]

5-11 — International Conference on Nutrition, Rome [Contact: Food and Agriculture Organization/WHO Joint Secretariat for the ICN, Villa delle Terme di Caracella, 0110, Rome, Italy, tel. 39-6-5797/3627]


11-12 — Financial Institutions and Macroeconomic Instability in Historical Perspective, Cambridge, Massachusetts [Contact: Kirsten Davis, National Bureau of Economic Research, 1050 Massachusetts Avenue, Cambridge, MA 02138, tel. 617-868-3900]

January 1993

19-23 — International Recycling Congress and Exhibition, Geneva, Switzerland [Contact: Orgexpo, Box 112, CH-1218 Grand-Saconnex, Geneva, Switzerland, tel. +41-022-798-1111, fax +41-422-798-0100]

February