A WORLD BANK POLICY RESEARCH REPORT

BUREAUCRATS IN BUSINESS

THE ECONOMICS AND POLITICS OF GOVERNMENT OWNERSHIP

Bureaucrats in Business

The Economics and Politics of Government Ownership

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Foreword

PUBLICATION OF THIS REPORT COMES AT A PROPITIOUS TIME. Throughout the developing world and in the transition countries, governments are striving to reform their economies. Yet in many countries, particularly the poorest, some parts of the economy have remained stubbornly resistant to reform. This report deals with one of the more important of these: the inefficient, loss-making state-owned enterprises that are a significant burden on government budgets and scarce resources in many countries. These enterprises hinder growth, impede market liberalization, and thus both directly and indirectly limit efforts to reduce poverty.

Drawing on a unique data base and detailed case studies, the report analyzes which types of state enterprise reform measures have worked best. It describes the formidable obstacles governments face when attempting to divest state-owned enterprises or otherwise improve their performance, and how successful reformers have overcome these barriers. It looks at company experience in depth and creatively applies institutional analysis to determine how contracts between management and government can serve as tools to reform enterprises. Finally, it suggests policy courses to be pursued under different country and enterprise conditions.

One central finding of the report is encouraging: some governments have indeed overcome the obstacles. Following a comprehesive reform strategy, they have divested when possible, and improved performance incentives for firms remaining in government hands. Trade and investment have usually followed, bringing more rapid growth and enhanced opportunities for society at large.

But why haven't more governments privatized or otherwise reformed state-owned enterprises? Reform entails political costs. Because politics is integral to reform, a study of reforms in public ownership cannot exclude political analysis. A key finding of the report is that political obstacles are the main reason that state enterprise reform has made so little headway in the last decade. The report makes an innovative attempt to objectively disentangle and measure the elements that constitute the political constraints on reform. While this is a significant contribution, we should also bear in mind that our analytical knowledge of political processes, though arguably older, is less complete than that of economic forces and motives. It is an area in which additional analytical work and more data will no doubt enhance our knowledge in the years to come. However, it is our belief that the thrust of the main findings of this study will hold true even with further scrutiny and more observations.

We hope that the research presented in this book will give political leaders, policymakers, and the broader development community a clearer picture of the substantial benefits that could result from state-owned enterprise reform and, just as important, a better understanding of how the obstacles to reform can be overcome.

Bureaucrats in Business is the fourth in a series of Policy Research Reports designed to bring to a wide audience the results of World Bank research on development policy issues. While accessible to nonspecialists, books in the series also seek to move forward the discussion among academics and policymakers of the appropriate public policy objectives and instruments for developing economies. Like previous Policy Research Reports, this report is a product of the staff of the World Bank; the judgments made herein do not necessarily reflect the views of its Board of Directors or the governments that they represent.

Michael Bruno
Vice President, Development
Economics, and Chief Economist
The World Bank

September 1995

The Report Team

THE REPORT TEAM WAS LED BY MARY SHIRLEY. THE PRINCIPAL co-authors were Ahmed Galal and Mary Shirley; Philip Keefer was the principal author of chapter 4. Sections draw heavily on work by Asli Demirgüç-Kunt and Ross Levine (finance), Alan Gelb and I. J. Singh (transition economies), and Hafeez Shaikh (management contracts). Bharat Nauriyal compiled the statistical appendix and provided research assistance; Luke Haggarty wrote many of the boxes and provided research assistance. Other assistance was provided by Abdalla Gergis, Rebecca Hife, and Clemencia Torres. Herbert Baer wrote box 2.9, Gerald Caprio wrote box 5.3, and David Wheeler wrote box 1.3. The report was produced under the direction of Lyn Squire and Michael Bruno.

Lawrence MacDonald was the principal editor. The editorial-production team for the report was led by Jenepher Moseley, with additional help from Luke Haggarty, Audrey Heiligman, and Bill Moore. Polly Means produced the graphics. Alfred Imhoff provided additional editorial advice. The support staff team was led by Zeny Kranzer and included Daniele Evans, Bill Moore, and Paulina Sintim-Aboagye.

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Definitions

LOW-INCOME AND MIDDLE-INCOME ECONOMIES ARE SOMEtimes referred to in this report as "developing economies." The use of the term is convenient; it is not intended to imply that all economies in the group are experiencing the same kind of development or that other economies have reached a preferred or final stage of development. Classification by income does not necessarily reflect development status. Similarly, the term "industrial economies" has been used for high-income economies and is not intended to imply that countries in other groupings are unindustrialized nor that industry is the sole determinant of economic development.

Economy Groups

- *Low-income economies* are those that had a 1992 per capita income of $675 or less
- *Middle-income economies* are those that had a 1992 per capita income of $676 to $8,355
- *Developing economies* are those that had a 1992 per capita income of $8,355 or less
- *Industrial economies* are those that had a 1992 per capita income of $8,356 or more

Geographic Groups

THE FOLLOWING ARE GENERAL GUIDELINES TO THE GEOgraphic analytical groupings used in this report. Some calculations, graphs, and tables use varying geographical definitions because they are based on different data sets. Sources should be consulted for the exact group composition.

Africa	Generally includes all of Africa. *Sub-Saharan Africa* excludes the North African countries of Morocco, Algeria, Tunisia, Libya, and Egypt.
Asia	Includes South Asia, Southeast Asia and the Pacific, and nontransitional economies in Central Asia.
Latin America	Short for *Latin America and the Caribbean*; refers to all American and Caribbean economies south of the United States.
Transition economies	Refers to the former socialist economies in Central and Eastern Europe, Central Asia, and China.

Complete coverage may not be available for all countries in each group. See the technical notes in the statistical appendix for specific countries in the different groupings.

Data Notes

HISTORICAL DATA IN THIS BOOK MAY DIFFER FROM THOSE IN other World Bank publications if more reliable data have become available, if a different base year has been used for constant price data, or if countries have been classified differently.

- *Billion* is 1,000 million.
- *Dollars* ($) are current U.S. dollars unless otherwise specified.
- *Net aid flows* are disbursements net of principal payments + interest

Acronyms and Abbreviations

ADB	Asian Development Bank
ADI	African Development Indicators (World Bank)
AfDB	African Development Bank
CFA	Refers to the CFA franc, a currency known in West Africa as the "franc de la Communauté financière d'Afrique" and known in Central Africa as the "franc de la Coopération financière en Afrique centrale"

CPI	Consumer price index
DFI	Direct foreign investment
ECU	European currency unit
EU	European Union
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross national product
IBRD/IDA	International Bank for Reconstruction and Development/ International Development Association (the World Bank)
IDB	Inter-American Development Bank
IMF	International Monetary Fund
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
ROA	Return on assets
UNDP	United Nations Development Programme
TFP	Total factor productivity
TVE	Township and village enterprise (China)
S-I	Savings minus investment
SOE	State-owned enterprise
WTO	World Trade Organization (successor to GATT)

Contents

Introduction and Overview

BUREAUCRATS ARE STILL IN BUSINESS. DESPITE MORE than a decade of divestiture efforts and the growing consensus that governments perform less well than the private sector in a host of activities, state-owned enterprises (SOEs) account for nearly as large a share of developing economies today as twenty years ago. Indeed, as data compiled for this study show, the size of the state-owned enterprise sector has significantly diminished only in the former socialist economies and a few middle-income countries. In most developing countries, particularly the poorest, bureaucrats run as large a share of the economy as ever. Government employees operate a casino in Ghana, bake cookies in Egypt, assemble watches in India, mine salt in Mexico, make matches in Mali, and bottle cooking oil in Senegal. In many developing countries that continue to support large SOE sectors, inefficient state-owned firms generate deficits that hinder economic growth, making it more difficult for people to lift themselves out of poverty.

Consider these facts:

- In many developing economies, SOEs absorb a large amount of funds that could be better spent on basic social services. In Tanzania, central government subsidies to SOEs equal 72 percent of central government spending on education and 150 percent of central government spending on health.
- SOEs often capture a disproportionate share of credit, squeezing out private sector borrowing. In Bangladesh, SOEs take about one-fifth of domestic credit, although SOE output accounts for less than 3 percent of gross domestic product (GDP).