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Book Review — Digitized Version

[Book Review of] Public enterprise in less-developed countries, Cambridge, New York, 1982

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Jones, Leroy P. (Ed.), with Richard D. Mallon *et al.*, *Public Enterprise in Less-Developed Countries*. Cambridge, New York, New Rochelle, Melbourne, Sydney 1982. Cambridge University Press. XVII, 348 pp.

There is a vast amount of literature on public enterprises which can hardly be overlooked. This is especially true with respect to public enterprises in developing countries. Consideration is given to a wide range of questions. On the one hand, it is asked what the economic rationale might be for the state to run its own enterprises. On the other hand, the existence of public activities in the field of production is taken for granted and emphasis is laid on decision-making processes, control and accountability of public enterprises, risk behavior of public managers and incentive structures as various means to achieve a greater efficiency. Case studies reporting different experiences of different countries in a rather specific manner contrast sharply with purely theoretical work, for example, on optimal pricing and investment policies of public enterprises under various settings.

The reader, a bit confused by the diversity of both questions and answers on public enterprise issues, will appreciate the book edited by Leroy P. Jones summarizing the state of the art in many respects. The 16 papers chosen for publication in this volume illustrate the wide range of issues addressed by the second Boston Area Public Enterprise Group Conference in April 1980. Asking "Why public enterprise?", Jones and Mason stress the role of economic factors in determining size and structure of the public sector. They refer to the well-known market failure debate in assessing benefits and costs of public enterprises as compared to alternative intervention measures. According to their view, public enterprises are best suited for large-scale production in capital-intensive industries with high forward linkages where private initiative to take the lead is rather weak in developing countries. However, the question remains whether the lack of private entrepreneurs in these areas really is the result of market failures and risk aversion. Both theoretical considerations and empirical findings tell us that for most developing countries it makes no sense to invest in capital-intensive industries because of comparative disadvantages. Social benefits of public enterprises engaged in these industries are therefore highly debatable; they may rather reflect a public failure involving substantial social losses through a misallocation of scarce resources. Dealing with sociopolitical factors affecting the role public enterprises play in developing countries, Ahmad in his paper is hardly interested in the question of economic costs of public production. Consequently, Part I of the book does not give us an economically stringent answer as to "Why public enterprise?".

In Part II, two papers focus on the control of public enterprises and consider the problem of multiple and inconsistent objectives laid down by different principles. Aharoni wants an independent goal audit, conducted by a third party, to be introduced in order to force economic decision-makers to argue on trade-offs and choices to be made. Howard stresses the role of direct community input that bypasses political and bureaucratic intermediaries, achieved, for example, by providing for worker and consumer representation on enterprise boards. It will be extremely difficult, especially in the latter case, to make proposals work in practice. Obstacles in organizing consumer interests are well-known. To empower community representatives to effectively control and influence the decision-making process in public enterprises will be a further arduous task. In many instances, consumer interests may be best served by strengthening

economic competition via deregulation instead of devising rather complicated control mechanisms for public monopolies.

The papers by Kelly, by Bhatt and by Vermeulen and Sethi fall under the heading "How are decisions made in practice?". It is by now widely agreed that public managers, as politicians and bureaucrats, are not maximizers of social welfare but try to pursue their own interests. Kelly identifies two types of managers in public enterprises, "engineers" and "commissars", the former like private entrepreneurs primarily interested in profits, the latter striving for a political career and therefore maintaining good relations with government. In her view, public enterprise behavior and outcomes depend significantly on the internal interplay of both types of managers, which is exemplified by a case study of two mineral-based conglomerates in Latin America. It remains unclear, however, which conclusions can be drawn in order to raise economic efficiency of public enterprises. In Kelly's own words "this chapter failed to advance far down the road toward predicting regularities and making general statements" (p. 125).

In another case study Bhatt describes an Indian "success story", namely, the design and production of a new tractor largely based on indigenous technology. Adequate institutional linkages among the various government agencies involved in a project, according to Bhatt, can be substitutes for market competition in producing pressures for efficient outcomes. Whether the final production of the tractor actually was a success in terms of social benefits and costs seems open to debate. Bureaucratic interferences caused many delays and the economic costs of the lasting political struggle are not accounted for.

Vermeulen and Sethi in their paper try to explain the striking evidence that public Indian firms lost less than one-fifth as much of working time to strikes as private firms. However, the empirical test of different hypotheses fails, lacking adequate data.

Three other papers concentrate on international trade activities of public enterprises. Public exports are of some importance, especially in raw material markets. Focussing on iron ore (Vernon and Levy) and bauxite markets (Rodrik) respectively, two papers analyze differences between private and public enterprises in strategies to stabilize markets. Whereas the former were strongly favoring vertical integration – a mine in a developing country typically linked to a parent mill in an industrialized country, in order to reduce risk –, the latter tried to achieve stability, for example, by building new mills within the country, through long-term contracts and through state-to-state trade agreements. Vernon, Levy and Rodrik all express doubts as to how effective the stabilization efforts of public enterprises can be. In addition, there is reason for concern that some measures, especially huge public investments in domestic mills, will result in considerable economic costs because, probably, resources are employed rather unproductively in such projects, considering comparative advantages of developing countries. In this context, the perception of developing countries processing their raw materials irrespective of costs, of governments subsidizing the use of capital in public enterprises, and similar interferences in a market-based allocation of resources is most important; surprisingly, however, a critical evaluation of these measures is not presented by the authors.

In the third paper, Jones and Wortzel, turning to manufactured exports, point out that the poor export performance of public enterprises in manufacturing is due to developing countries' comparative production advantage in labor-intensive products whereas the comparative institutional advantage of public over private enterprises is

in capital-intensive activities. However, so-called institutional advantages are mainly derived from observations of actual production patterns and characteristics. Whether empirical evidence is in fact a consequence of institutional advantages or merely a result of policy-induced distortions in allocation is highly debatable. The same applies to the reasoning that public enterprises "should be willing to take more risks than private enterprises" (p. 237); the wide-spread assumption that private entrepreneurs in developing countries are to a socially unacceptable extent risk-averse has not been proved conclusively as yet.

The risk perception of public enterprises is dealt with by Tandon. However, the effects of hierarchical structure in compounding risk aversion can be similarly observed in large private enterprises. Gillis, Jenkins and Lessard are concerned with public enterprise finance. They argue that the financial structure affects not only the distribution of public enterprise surplus but also its magnitude, as it alters managers' motivation to produce surplus. The conclusion that "non-conventional financial instruments need to be designed so that both public-enterprise managers and governments will have an incentive to minimize the distortions created by financial illusion" (p. 275), however, remains a rather sweeping statement.

The exceedingly difficult task of constructing an incentive system which guarantees public enterprise efficiency is tackled by Finsinger and Vogelsang and by Manove. Both papers do not refer specifically to developing countries. Even for countries with better administrative capabilities than most Third World countries the practicability of model solutions cannot be assured. In addition, Manove's findings that public enterprises are superior in acting in the public interest vis-à-vis a central planning scenario and government regulation of private enterprises, largely result from assumptions which are, at least in part, rather restrictive and unrealistic.

Mallon also tries to compare the public enterprise tool with other intervention mechanisms, focussing on Malaysian experiences in strengthening ethnic Malay entrepreneurial activities. However, in asking how cost-efficient the use of public enterprises has been relative to formerly applied entrepreneurial support measures no definitive conclusions are reached.

Finally, Mintz theorizes on redressing the market failure of imperfect capital markets that limit private risk sharing and thus reduce investments to levels below those which are socially desirable. According to Mintz, government equity participation can be a substitute for a perfect capital market. The author's confidence in governments allocating financial resources in a socially optimal manner is not shared by this reviewer; "inaccurate expectations generated by misinformation about the future" (p. 328) which are made responsible for private decisions deleterious to social welfare are also to be found in the public sector.

To sum up, the book provides the reader with a comprehensive overview of the "underdeveloped state of public-enterprise research" (p. 13). The wide range of issues addressed has the inevitable consequence that different papers are at most loosely connected. The deficit in research on public enterprises mainly located in the empirical-analytical area is hardly reduced by the book. Most papers do not result in stringent policy conclusions adequate for being implemented by practical economic policy. It has to be acknowledged, however, that it is largely due to data limitations that a careful evaluation of public enterprise effects on further development of Third World countries

is still missing. Finally, authors are often exclusively concerned with reducing inefficiencies in public enterprises through appropriate incentive systems, etc., taking the existence of public enterprises for granted and thereby neglecting alternatives which may be better suited for achieving economic and social aims. It has to be kept in mind that there are not only market failures but also government and bureaucratic failures which may cause considerable economic costs.

Peter Nunnenkamp

Lall, Sanjaya, *Developing Countries in the International Economy. Selected Papers*. London, Basingstoke 1981. The Macmillan Press Ltd. XI, 263 pp.

This is the second collection of articles by Lall¹. Five of these have been published in different journals (*World Development*, *Journal of World Trade Law and Research Policy*) and one out of the remaining three articles has been reprinted from the book *Technology, Employment and Basic Needs in Food Processing in Developing Countries*, edited by C. G. Baron in 1980. Most of these articles deal with foreign direct investments and the associated transfer of technology to host developing countries.

The first article "Dependence and Underdevelopment" is a valuable comment on dependency theory. It is more so as it comes from one of the sympathisers of this school of thought. The basic concept of this school consists of a description of disadvantages of the capitalist mode of development for poor countries and as such cannot be accepted as a theory of development. Moreover, dependence and fears of its serious consequences as painted by representatives of this school are not found in practice, not even in the strongholds of this school, viz., in Latin American countries. There cannot be one-sided dependence of one country on another, at least not in the case of bigger economies. International economic relations generally lead to interdependence of the related countries. This is demonstrated currently even in the field of international indebtedness of Latin American countries where it was hardly expected to arise. In contrast to this discussion, the author shows in the following chapter some of the limitations of conventional welfare economics to deal with development problems of poor countries. He indicates, however, no alternative paradigm to solve them.

Chapter III is a review article. Lall takes a nationalist's stand and criticises G.L. Reuber *et al.*, the authors of *Private Foreign Investment in Development* (Oxford 1973) for their business and traditional economic approach and for not having spelled out the underlying value judgements in the book.

The following three chapters are devoted to problems of transfer of technology to developing countries. One of these deals with multinationals in the food-processing industry, especially with the role of Unilever in developing countries. Another chapter (V) is a brief survey of the existing literature on main issues in this field. In the last article on this subject, the author concludes that the costs of the patent system to LDCs have been overemphasized in the literature. Whether a developing country stands to reap a net benefit or loss from the existing international patent system depends on its political-economic structure. Adherence to patent laws promotes domestic innovation in a

¹ The first one (*Multinational Corporation: Nine Essays. London 1980*) was reviewed in Vol. 117, 1981, pp. 794–795 of this journal.