Market Liberalization (ML)

Market Liberalization - reforms

- As the economies of developing countries continued to deteriorate in the wake of both external and internal shocks, LDCs experienced increasing difficulties in obtaining external loans and became more dependent upon the IMF and the World Bank for financial support.
- The World Bank observed that stabilization measures implemented by LDCs had often fuelled inflation, e.g. **increased borrowing, foreign exchange controls, the extension of price controls, increased import tariffs and control of imports through licensing.**

Market Liberalization - reforms

- It was soon apparent that these remedies were ineffective and alternative solutions had to be found.
- International funding agencies began to insist that borrowing governments implement an economic structural adjustment program (ESAP).
- The reform or liberalization of markets including agricultural and food markets, has been a central element of ESAPs. In agrarian based economies, **reform of the agricultural and food markets has been the single most important component** of ESAP.

Market Liberalization – reforms

- The World Bank first applied the term *structural adjustment* to describe its program of policy-based lending which began in the early 1980s.
- The objectives of SAPs (public sector management and resource allocation, market liberalization and reform of supporting institutions) are not confined to restoring macro-economic balance but are also intended to stimulate economic growth.

Market Liberalization – reforms

- Structural adjustment involves improving the structure of production by allocating resources in accordance with their opportunity cost rather than on any other basis.
- The argument in support of this approach is that resource allocation efficiency is maximized, increasing the value of current output and improving the prospects for the rate of growth over time and avoiding the need for subsidies and taxes in support of the production structure.

Market Liberalization - reforms

- In addition to increased allocational efficiency, structural adjustment is concerned with improvements in both operational and economic efficiency.
- Operational efficiency is increased when unit costs of production are minimized through efficient management and the adoption of the appropriate technology.
- Economic efficiency is the consequence of a high level of allocational efficiency plus a high level of operational efficiency and ensures that consumers' needs are satisfied at prices which reflect the minimum sustainable cost of production.

Market Liberalization - reforms

- Overall the objectives of ESAP are to:
  - restore equilibrium in the balance of payments
  - reduce the fiscal deficit to a manageable size
  - bring down inflation
  - improve long term employment prospects
  - increase investment and
  - lead to sustained growth.

Market Liberalization - reforms

- In order to achieve these objectives policy makers must:
  - identify an agenda of reforms in policies and institutions
  - develop a sequence of measures which is technically consistent and politically sustainable and
  - negotiate these policies between governments and the lending agencies.

Market Liberalization - reforms

- The objectives themselves are at the macro-economic level.
- In most instances they are attempted through policies designed to manipulate supply rather than demand.
- These policies are directed towards reducing spending overall and redirecting demand towards domestically produced goods.

Market Liberalization - reforms

- The World Bank began its SAP in the early 1980s and viewed this as a short term divergence from the business of lending for projects.
- The expectation was that most countries that instigated SAPs would have completed them within three years.
- Both the duration of individual programs and the extent to which the Bank would be involved in policy-based lending were woefully miscalculated.

Market Liberalization - ESAP

- Some SAPs have extended over eight years or more, and many had second and third phases. Moreover, the World Bank's involvement in funding these program has continued to increase, rather than diminish.

ML - Macroeconomic Stabilization

- The World Bank has been the principal sponsor of ESAPs, which focus on the supply side of economies and impact indirectly on the demand side, and the IMF has been the champion of economic stabilization programs.
- The stabilization measures (monetary policy, fiscal policy and devaluation) have a direct impact on the demand side (FAO,1990).
- Stabilization policies work to reduce a country's expenditure levels to match its current resources. They do not directly lead to higher growth rates but rather provide the economic stability necessary before increased growth can be a real prospect.

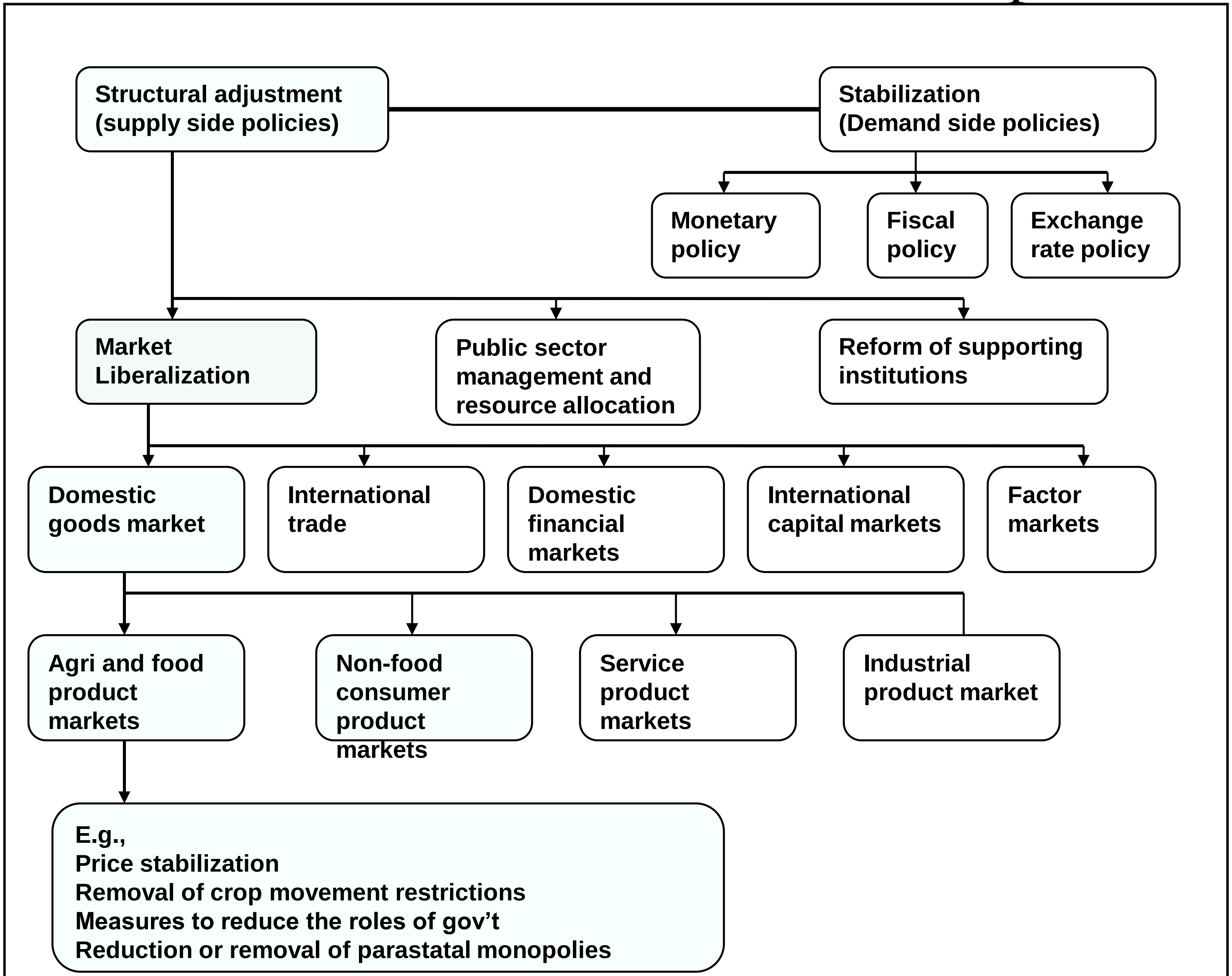
ML - Macroeconomic Stabilization

- The policy instruments typically employed in the pursuit of economic stabilization are:
  - exchange rate policy
  - fiscal policy and
  - monetary policy
- Example, export performance (demand) might be improved because the reforms could result in a devaluation of the local currency (exchange rate policy), and/or higher levels of investor confidence due to inflation being contained as government brings its own spending under control (fiscal policy) and interest rates are allowed to rise to their economic level (monetary policy).

ML - Macroeconomic Stabilization

- Market liberalization is not only a supply side or structural adjustment instrument, it also has the capacity to contribute towards macro-economic stabilization since if it is successful in increasing efficiency it becomes possible to reduce subsidies without necessarily having a detrimental effect on the welfare of subsidy recipients.

Nature of Stabilization and SA policies



ML - Macroeconomic Stabilization

- There is much debate about the sequencing of reform measures.
- Discussion centers around the ordering of
  - structural adjustment vs stabilization,
  - liberalization of domestic vs international markets, and
  - the sequencing of measures intended to liberalize specific markets.
- There appears to be a widespread consensus that the liberalization of domestic markets particularly those in the agricultural sector should precede attempts to liberalize international trade.
- It is argued that success in liberalizing domestic markets would help establish a more robust and flexible economy, one better able to compete in international markets

ML - Macroeconomic Stabilization

- A central objective of structural adjustment has been to remove distortions in the economy resulting from government intervention and central control over markets.
- A secondary objective has been to improve the management of those activities that remain the responsibility of the state in the post-market liberalization period.

ML - **The role of the state in liberalized markets**

- The efficient allocation of resources is central to all structural adjustment programs. This does not preclude the participation of the state in agricultural production and marketing activities.
- Historically, however, government involvement in many areas of economic activity has proved to be allocationally and operationally inefficient.
- It has been argued that government structures are not flexible enough to react to changing opportunity costs. Moreover, resources are often allocated on the basis of political considerations and operational inefficiencies arise from the absence of incentives.
- As a result, structural adjustment has also involved reducing the direct role of the state in marketing.

ML - Strategies for reforming agricultural marketing parastatals (AMPs)

- Strategies for reforming AMPs
  - Countries undertaking market reforms have had to face the vexing question of what to do about government agricultural marketing institutions.
  - In broad terms, there are four alternative courses of action which can be taken with respect to the restructuring of agricultural marketing parastatals.

Strategies for reforming AMPs

- The alternative courses are
  - abolition of the parastatal, passing its essential functions to the private sector and/or non-government organizations (NGOs)
  - transformation of the parastatal into a non-commercial organization carrying strategic food reserves and stabilising prices
  - transform the parastatal into a fully commercial enterprise, operating as a market oriented, profit making concern and
  - transform the parastatal into a fully commercial enterprise, operating as a market oriented and profit making concern within a competitive marketplace.

ML - Strategies for reforming AMPs

- Privatization can have the following policy directions
  - Privatization of management
  - Privatization of non-core assets and functions
  - Partial sale of equity
  - Full privatization
- The options discussed here need not be considered as being mutually exclusive. It is conceivable that several elements could be combined within a single reform program.

Challenges in commercialization and privatization of AMPs

- Any form of parastatal marketing organization, can be commercialized and/or privatized.
- The process of commercializing an agricultural marketing parastatal involves management in establishing return-on-investment, turnover and profit targets.
- In order to achieve these targets the parastatal is expected to adopt a market orientation.

Challenges in commercialization and privatization of AMPs

- Privatization takes the additional step of transferring ownership of the parastatal out of the public sector and into the custody of private investors.
- The transfer of ownership can be effected in a number of ways. Shares in the enterprise can be sold to special interest groups such as management, employees or suppliers.

Challenges in commercialization and privatization of AMPs

- The restructuring of a public enterprise involves two key preliminary steps:
  - transformation into a genuinely viable commercial enterprise, earning a realistic return on capital and with a balance sheet fully aligned to trading results.
  - transformation of the enterprise's special legal status into that of a normal commercial institution with no special trading rights or privileges conferred by statute.

Challenges in commercialization and privatization of AMPs

- The challenges
  - **Accumulated deficits**
    - AMPs which are in a relatively strong financial position are far better placed to undertake restructuring than those carrying large, accumulated deficits.
  - **Source of finance**
    - Many AMPs carry large deficits and need fresh injections of cash. However, the magnitude of there deficits usually discourages commercial lending institutions from supporting them.

Challenges in commercialization and privatization of AMPs

– **Tax liabilities**:
  - How governments treat the losses made by AMPs prior to privatization will have a significant bearing on how they are perceived by potential investors.
  - The magnitude of the losses are such that if the accumulated losses were written off against future profits, it might be a very long time before the enterprise paid any tax.
  - On the other hand, if no allowance is made for these losses then the AMP constitutes a most unattractive investment.

Challenges in commercialization and privatization of AMPs

- **The challenges**
  - **Developmental roles**
    - AMPs frequently have development roles, i.e., activities and projects aiming to contribute to the long term development of a sector of agriculture, a section of the population and/or a region of the country.
    - This makes it difficult to deal with the restructuring or reform of an AMP in isolation from an array of confounding development issues.
  - **Legislation**
    - The restructuring or reform of AMPs will invariably involve the amendment or repeal of a substantial body of legislation relating to an AMP and the products for which it has been responsible.

Encouraging private sector involvement in agricultural marketing

- In many cases the donors or lending institutions have made market liberalization and encouragement for increased private sector participation part of the conditions attached to their structural adjustment loans.
- In some instances, the reform or abolition of a loss-making AMP has also been part of the agreement between the lender and the loan recipient.

Encouraging private sector involvement in agricultural marketing

- In some cases, strong 'informal' or parallel marketing channels have co-existed with the formal channel throughout the period of administered pricing and "controlled" marketing of agricultural products.
- When these markets are deregulated the process of transferring 'informal' marketing functionaries into the formal sector tends to occur quickly.

Encouraging private sector involvement in agricultural marketing

- On the other hand, where governments have been successful in suppressing informal marketing activities, the experience and culture of entrepreneurship and risk-taking may have been lost, or at least significantly diminished.
- In these cases, private sector participation in deregulated markets is a much slower process.

Impediments to private sector participation in agricultural markets

- Initially, the World Bank attached great importance to increasing the efficiency of AMPs as a means of bringing about market reforms.
- After all, AMPs typically represented a sizeable burden upon the governments of LDCs and were characteristically inefficient.

Impediments to private sector participation in agricultural markets

- In due course the World Bank began to see greater potential in the liberalization of markets and the privatization of marketing institutions.
- Marketing reforms have tended to follow a pattern.
  - In most cases, the first step has been to enfranchise private traders and actively encourage them to participate in markets from which they were previously excluded.
  - The next step has been the removal of price controls. Marketing subsidies and parastatal subventions are then removed before the final act of market reform, i.e. the lifting of controls on international trade in agricultural products.

Necessary interventions to promote efficient private sector

- Encouraging and policing competition
- Promoting the wider availability of information
- Maintaining appropriate quality standards
- Strengthening the legal system to ensure enforceability of contracts
- Providing an adequate transport infrastructure
- Undertaking spatial planning to allow appropriate access by marketers and consumers to central places

Necessary interventions to promote efficient private sector

- Supporting the development of credit
- Research into the technological problems in storage and processing experienced by the private sector (which will be likely to be operating on a smaller scale, and facing different relative factor prices than parastatals) and
- Training in technical and managerial aspects of marketing, processing and storage.

Potential impediments to private sector participation in agricultural markets

- **Policy implementation**
  - Even when government is committed to encouraging private sector participation in agricultural marketing, the bureaucracy which implements policy changes may be less committed.
  - It is therefore not impossible that government policy is undermined at the implementation stage.
- **Licensing**
  - A common post-liberalization regulation is the requirement for traders to be licensed.
  - At the beginning of a liberalization process, licensing regulations may not be well publicized, or may change, leading to uncertainty among traders.

Potential impediments to private sector participation in agricultural markets

- **Quantitative restrictions**
  - Traders are sometimes limited to transporting loads of a specified amount. This can impose costs on traders – as there may be economies of scale, which increase the efficiency of the marketing system.
- **Rigid and uncertain regulations**
  - Regulations, rather than direct intervention measures, can be the principal instrument of government policy.
  - The uncertainty surrounding the regulations which are to apply to the private sector can prove an impediment to private sector participation in agricultural marketing.
  - During the early stages of market liberalization, changes to regulations may occur fairly frequently and this unsettles would-be investors in the agricultural marketing system.

Potential impediments to private sector participation in agricultural markets

- **Price regulation**
  - In order to retain a measure of control over food prices some governments have continued to impose price regulations in the post-market liberalization era. These frequently take the form of floor and ceiling prices.
  - These can have a substantial impact upon private trade.
- **Public and private sector competition**
  - In many countries, liberalization has allowed for the co-existence of private and public sector agricultural marketing institutions (i.e. parastatals and/or government supported co-ops).
  - Problems arise when public sector bodies benefit from support which is not extended to the private sector.

Potential impediments to private sector participation in agricultural markets

- **Inadequate infrastructure**
  - A major problem for traders in many countries is the low investment in infrastructure.
- **Credit constraints**
  - Most small traders have restricted access to formal credit markets, and tend to borrow from informal sources. These can be extremely expensive sources of funds and often lock the borrower into a never-ending cycle of debt.
  - Lack of access to credit and finance prevents small traders from expanding. The quantities of commodities bought and sold, the amounts stored and transported and the ability to exploit economies of scale are all restricted by poor access to credit.

Potential impediments to private sector participation in agricultural markets

- **Marketing information**
  - With long established private sector marketing systems, informal networks usually exist to provide traders with information on market conditions, prices and the credit-worthiness of other parties.
  - Conversely, where suppression of the private sector has been effective, in the past, the marketing information system tends to be underdeveloped.

Government action to improve private sector performance

- There are a number of areas in which government can support the development and expansion of the private sector.
- **Clear policy statements**
  - The state has to make clear its view of the role of the private sector in agricultural marketing system, i.e. it must have clear objectives with the respect to the marketing system.
  - It is equally important that the extent of the future involvement of the public sector in the agricultural marketing system be clearly articulated. If the public sector is allowed to enter the market, it must be known under what conditions, at what prices, and for what purpose this will occur.

Government action to improve private sector performance

- **Regulatory framework**
  - All too often in SAPs the need for supporting legislation is either under-estimated or neglected altogether. Government can provide a set of stable regulations which would:
    - clearly lay out the rights and obligations of consumers, producers and traders, underpinned by a carefully constructed contract law
    - establish an acceptable system of weights and measures and perhaps a product grading system
    - clearly specify the kind of exchanges that are legal, between which parties, and the constraints placed upon the place of exchange and
    - the designation of an inspectorate to enforce the rules and regulations.

Government action to improve private sector performance

- **Training**
  - Many of the entrepreneurs who come into a liberalized market will lack the basic knowledge and skills to ensure that their businesses can survive the periodic adverse economic conditions.
  - If government wishes to establish a private sector capable of growth and development then training programs will be required.
  - This does not necessarily mean that government has to provide or even fund the training. It may mean, instead, that government facilitates the training.

Government action to improve private sector performance

- **Infrastructure**
  - Investment in roads, market places and storage facilities can reduce marketing costs and thereby increase levels of commercialization.
  - This might involve investing in new facilities and/or rehabilitating existing facilities.
- **Information systems**
  - The provision of market intelligence removes a barrier to market entry.
  - A government sponsored marketing information system would improve market transparency and help small-scale enterprises compete more effectively with larger organizations.

Government action to improve private sector performance

- **Transport**
  - Transport shortages are a common complaint among private sector agribusinesses. This is especially true of small-scale businesses located in rural areas.
  - Perhaps the best government can do is to give transportation a high priority within its foreign exchange allocation so that more vehicles, spares and fuel can be brought into the country.
  - Emphasis should be placed on increasing the number of vehicles in the possession of the private sector.

Government action to improve private sector performance

- **Credit**
  - Since poor access to credit and other forms of finance are a major obstacle to the private sector, especially the small-scale operator, government may have no choice but to get involved in establishing appropriate lending schemes.
  - Alternatively, government can encourage commercial banks to set special loan schemes targeted at various sub-sectors of agriculture and agribusiness.
  - Due to the inherent risks in agriculture, and in dealing with small businesses with very limited resources, lending institutions will probably require some form of government underwriting of these schemes.

End.