READERS' COMMENTS

Pension reform in Eastern Europe

Ms. Fox's plea for a Chilean-type pension reform in Eastern Europe does not convince me at all (see "Can Eastern Europe's Old-Age Crisis Be Fixed?" in *Finance & Development*, December 1995).

The existing pension entitlements/ debts are large and the labor market is sluggish so that current contributions can hardly finance the modest pensions averaging $15–25 per month that are now being paid out. Thus, the retirement age has to be increased, and disability as well as other special treatment criteria need to be tightened. Up to this point, nothing can be said against Ms. Fox's diagnosis and therapy. However, her proposal for diverting contributions toward a fully funded, mandatory, privately managed second pillar promises "substantial gains" from "shock therapy" without convincing figures. Moreover, she answers the question whether such a radical reform at the expense of the elderly is possible in a democracy by referring to the rather problematic cases of Argentina and Peru. Most important from an academic point of view, her implicit model is based on disputable economic reasoning, since investment and growth are not dependent on savings but on profit expectations.

The recent rise of ex-communist political parties in Eastern Europe and Central Asia may have something to do with these ultraliberal pension reform ideas so that, in the end, the World Bank fosters not only bad economics but also anti-profit political forces.

Prof. Dr. Manfred Nitsch
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Louise Fox responds:

In my article I recommended that Eastern Euopean countries move quickly to adopt a multipillar pension system with a funded second tier, such as is found in a number of Organization for Economic Cooperation and Development countries (e.g., Denmark, the Netherlands, and Sweden), as well as in many Latin American countries. Most economists agree that savings are important for investment and growth. The simulations showing the benefits of rapid reform are described in the World Bank study Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth, *pp. 339–42.*

Road reform in Africa

In their article, "Commercializing Africa's Roads" (*Finance & Development*, December 1995), Rupert Pennant-Rea and Ian G. Heggie propose bringing Africa's roads into the marketplace, putting them on a fee-for-service basis, and managing them like a business. These proposals are pertinent but fail to reflect some of Africa's realities. It is true that roads in Africa are neglected, but the vehicle fleet is also old—the average age of taxis and mini-cars in Senegal is 7 years, and that of trucks, 10 years. These vehicles operate at a rate of return of around 30 percent and cannot support a road tax.

To transport customers, drivers in Senegal and other West African countries must queue up in public garages. This system keeps rates of return low, so that transport companies do not have the funds they need to renew their fleets, and breeds corruption, as drivers pay bribes to obtain operating permits for older vehicles that do not meet standards. The elimination of public garages and the queuing system would allow new cars to circulate, give passengers choices, lower the risk of accidents, and lead to the creation of private garages and improved service.

Privatization of the transportation sector is urgent. Private initiative will breathe new life into this sector, the veritable driving force of economic development.

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What was the tequila effect?

The article by Carrizosa, Leipziger, and Shah, "The Tequila Effect and Argentina's Banking Reform" in *Finance & Development,* March 1996, does not really address the core questions it poses. For one thing, it does not define the "tequila effect" (p. 23) nor does it spell out whether "the disruption of Mexico's economy in late 1994" and its concomitant spillover effects were *sui generis*. If anything, it suggests the opposite by concluding that "the devaluation of the Mexican peso on December 20, 1994, and the resulting capital outflows throughout Latin America triggered the crisis" (p. 24). If the resultant capital outflows were a continental phenomenon, what then were the exceptional feature of their impact on Argentina and the related transmission mechanism? Why were other Latin American countries spared the Argentinean type of crisis?

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Reforming government

"Reforming Government in Industrial Countries" (*Finance & Development*, September 1996) is more ideological than scientific. The size of the public budget is, to a large extent, a function of institutional arrangements and accounting practices. It is not an indicator of the quality of a government or, for that matter, of a society. Economic theory does not dictate whether a retirement, health, or unemployment insurance system should be operated on-budget or off-budget, or in the public or private sector. The distinction between the public and private sectors is often blurred. For example, in certain countries, the military was partly self-financed from its own enterprises and its budget greatly understated. In many instances, regulation, which imposes a burden on the private sector, performs the same function as treasury outlays. The recommendation advanced in the article that the public sector should not be higher than 30 percent of the [country's] GDP can have no practical importance unless there is international comparability in budgetary practices.

Historically, the state has always provided economic favors to selected people and groups, but its primary intent has not been to redistribute wealth from the rich to the poor—it has generally been the opposite. There is a need to eliminate subsidies and expenditures that benefit certain groups without any economic or social justification. There are, without doubt, low-income individuals who misuse welfare programs, but such derelictions pale before the benefits that flow to the rich and powerful. Bloated budgets are not due to excessive devotion by governments to the poor and unfortunate. The welfare state does not spring from eleemosynary instincts or a desire for economic equality but is largely a device to avoid civil disorder and to buy votes.

The thrust of the article is that governments should limit their activities. But some countries need to increase outlays for infrastructure, rehabilitation of decaying urban centers, education and training, low-cost housing, and universal health and retirement insurance. Deficiencies in welfare programs should not obscure the need to devote public funds to important social objectives. To support their argument, the authors must demonstrate that changes in public resources devoted to social purposes, such as education and health, are not correlated with social outcomes. If one wishes to rely on budgetary data, public budgets need to be comparable across countries. Military expenditures and interest on the national debt should be excluded; insurance programs must be treated as off-budget items.

Monroe Burk
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Vito Tanzi and Ludger Schuknecht respond:

We have great difficulties in understanding the point that Mr. Monroe Burk wants to make about our paper, which he calls "more ideological than scientific." While on the one hand he informs us that "historically, the state has always provided economic favors to selected people and groups . . ."; that the state has often redistributed income and wealth from the poor to the rich; and that the welfare state was ". . . a device . . . to buy votes"; he objects to our conclusion that spending can be reduced in many countries without reducing the essential role of the state. He attributed to us a conclusion—that the public sector should not be higher than 30 percent of GDP—that we never reached. Whether the level of spending should or should not exceed 30 percent of GDP depends on how well the state can spend the money. Our conclusion—that once the 30 percent level is reached, there is no evidence that much good is produced from the excess over 30 percent—was based on positive rather than normative analysis. Mr. Burk's letter indicates that indeed there is a lot of scope for reducing public spending. Many governments have recognized this truth and have begun to put in motion forces that will eventually reduce the role of the state.

I read with interest the article by Tanzi and Schuknecht, "Reforming Government in Industrial Countries" (*Finance & Development*, September 1996). The tentative conclusion was that government spending as a percentage of GDP could be lowered from 50 percent to 30 percent. However, the authors were not clear on how that could be done or how to treat the numerous public agencies that are really part of the public spending sector but that act as if they are part of the private sector.

In Canada, such firms are known as crown corporations or parapublic agencies. They are government-owned monopolies, accountable only to the government. Profits are often paid out annually as dividends to the government, which uses this money for public spending. For example, Hydro-Quebec, a very large utility, by law must remit some Can$700 million every year (it can vary) to its only stockholder, the provincial government. The government allows it to increase rates every year, independently of any economic need. At the same time, the government demands cuts in the company's operating budget. Thus, the government is able to collect more money from the public without raising personal income taxes. Many such corporations exist throughout Canada.

Governments that raise money so easily via state-owned agencies can appear to be cutting public spending when they are simply transferring funds from one account to another. A serious analysis needs to take into account the flexibility that state-owned agencies offer governments in meeting, cutting, or increasing public spending.

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