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CONTENT

EDITORIAL

This edition of Dialogue focuses on the issue of public finances as it relates to structural adjustment policies in developing countries. Since its beginnings, DIAL has been studying the theme of public finances, albeit more on the expenditures than on the revenues side. Preparation for the "Journée des économistes de l'ORSTOM 1996", which was devoted to the issue of tax policy in developing countries, has however stimulated the writing of several papers on this subject by the economists of DIAL.

The two articles presented here deal with several aspects of the relationship between public finances and adjustment which have not been the subject of much detailed analysis to date. The first points out that, in addition to their short-term stabilising effect, government cut-backs have, because of their externality effects, structural implications which have not been sufficiently explored. The second article examines the links between the restructuring of the tax system implemented within the framework of structural adjustment programmes and the distribution of income in the affected countries.

The technical nature of these articles may surprise some readers of Dialogue, who will be accustomed to more accessible presentations. We feel, however, that the interest of these articles fully justifies their dissemination within the framework of our newsletter.

After moving and getting settled in our new quarters on rue d'Enghien, DIAL is preparing for a busy year in 1997. In addition to our regular research work, we are already involved in the organisation of three conferences for the coming year. The first, which we are preparing in conjunction with ORSTOM, will deal with the impact of the economic crises, which Africa has endured for over fifteen years, on the behaviour of individuals and households. This conference will take place in March in Aix-Marseilles, France, and will be attended by participants from research institutions and from academia.

DIAL is also co-ordinating the preparation of a seminar organised under the auspices of AFRISTAT, and supported by ORSTOM, EUROSTAT, the International Labour Office, and the British Overseas Development Administration, to examine the issue of the statistics and analysis of the informal sector. This seminar will bring together in Bamako, Mali, in March of 1997, representatives of some twenty African countries and a dozen institutions.

Finally, next summer DIAL will host in Paris the PARADI training school on computable general equilibrium models(CGEM), organised by Laval University of the City of Quebec. On that occasion, DIAL will organise a seminar of a few days, where CGEM specialists will present their work and debate recent advances in their techniques.

In concluding, we would like to mention that DIAL's team of doctoral students has upheld the level of excellence to which we have become accustomed. Ms Razafindrakoto received her doctorate in economics in October, with distinction and unanimous congratulations of the jury. She subsequently performed brilliantly at the recruitment competition of ORSTOM in November 1996, as did Mademoiselle Mesplé-Somps who had preceded her through the same academic successes. DIAL is extremely proud of its former doctoral candidates and we are delighted at the prospect of maintaining close working relationships with them.

Government Spending and Structural Adjustment

Despite the fact that budgetary policy lies at the heart of Structural Adjustment Programmes (SAPs) (See Mesplé-Somps (1995) and (1996) for a formal presentation of the demonstrations outlined in this article),its effects have mostly been examined as they relate to the demand side of the economy. This is because current account deficits result from the difference between internal demand and supply, and, according to the theory of absorption, any disequilibrium is absorbed, at least in the short run, by a reduction in aggregate demand, and hence in government spending. Consequently, budgetary compression is primarily a stabilisation measure, and its impact on the supply side of the economy has been insufficiently considered and, as we shall see, only partially analysed.

I. Traditional Analysis of the Effects of Budgetary Compression ...

The dependent economy model is most frequently used to analyse stabilisation and adjustment policies and macroeconomic equilibrium in the medium-term. This model distinguishes between domestically consumed goods (also called non-tradable) and goods which are exported and imported (tradable), and it allows us to study the impact of changes in expenditures (public and private).

In its simplest version, this model's assumptions are as follows. The external account deficit is identically equal to the government deficit (this is equivalent to postulating that private agents cannot lend to, or borrow from, the government or external sources). There is free access to foreign financing. The economy consists of two sectors of production: an export sector producing primary goods and a sector producing goods which are imperfect substitutes for an imported competitor. Only labour is mobile between the two private sectors.

Generally, public expenditure is viewed exclusively as a component of absorption, i.e. as an element of aggregate demand. Thus, a contraction in government spending results in a decrease in demand and, ultimately, in the price of domestically produced goods and a shift of productive resources into the export sector. The ensuing depreciation of the real exchange rate induces substitution of locally produced goods for imports in the private consumption bundle. Given that the production of tradable goods increases while the demand for imports declines, the trade deficit falls. **Consequently, the decrease in the government deficit results in a greater fall in the trade deficit, owing to the joint impact of increased exports and decreased imports**. Notice that only two mechanisms act on the re-allocation of resources: demand and price effects.

Neither the original SAP models, nor the critiques which followed their introduction, considered the fact that public expenditure may be a factor in the productivity of inputs an important contributor to the resumption of growth.

Empirical studies (Antle (1983), Chhibber (1988), Lee et Anas (1991), Kessides (1993), Beenhakker (1987)) in developing countries have however revealed that economic activities by the government as a provider of services and public goods have numerous impacts, direct and indirect, on private firms (in terms of factor productivity, output levels, and price formation), and that these impacts may vary between sectors.

These studies have thus shown that expenditures on transportation and communication are significant determinants of productivity differentials between the agricultural sectors of different countries. In fact, in countries with poorly developed infrastructure, improvements in these facilities contribute more to increasing the supply of agricultural output than do price variations.

Similarly, most productive activities use electricity, telecommunications, water and

transportation, to name a few, as intermediate inputs. Inadequate infrastructure entails a number of economic costs :

- ¿ first, direct costs resulting from production delays, from losses of perishable goods, and from the general underutilization of capacity,
- ¿ second, an increase in capital expenditure to compensate for limited access to public goods, and
- ¿ third, the spread of these increased costs through the rest of the economy. Analyses have revealed that between 25% and 60% of the final price of food stocks are transportation costs.

Incidentally, we notice that, at least since the beginning of the 90's, there has been a shift in the stance of the Bretton Woods institutions, where increasing attention is paid to defining the role of the government in recognition of its key contribution to allowing economies to operate at full potential.

In light of this assumed impact of government expenditure on supply and on the productivity of inputs, it appears useful to re-examine the appropriateness of budgetary policy in periods of adjustment.

II. ... vs. the Assumption of a Productivity Effect of Public Expenditure

If we accept that government expenditure creates public intermediate goods, i.e. goods which are required for private production, it follows that budgetary restraint translates to a reduced supply of a factor of production, and thus to a negative shock on private sector supply. This implies a reduction in households disposable income.

We can distinguish between three categories of public intermediate goods based on our assumptions concerning the intensity of the externality on private production:

- ¿ **Public goods which impact identically on all sectors**, such that the externality is symmetric. These may include general administrative expenditure, contributing to an improved functioning of the legal system or an increased overall level of security.
- ¿ **Public goods whose impact is strong on the tradable sector and weak on the non-tradable sector**. When this latter sector primarily comprises firms in the informal economy, we may assume that government activity has little relevance to it, and that it is the other sector which is the primary beneficiary. Otherwise, it may be that public expenditure directly benefits the export sector, such as when the government invests in the construction or maintenance of ports and roads.
- ¿ Finally, **public goods which benefit the non-tradable sector and do not affect the tradable sector**. When the non-tradable sector is concentrated in cities while the rural sector is export oriented, the expansion of municipal infrastructure to the exclusion of rural development may illustrate this case.

In all cases, a decrease in government spending induces a depreciation of the real exchange rate as the decline in public expenditure is compounded by the fall in agents' incomes resulting from the deterioration of factor productivity.

If budgetary compression affects the supply of public intermediate goods with limited externalities on overall private production, the price and initial demand effects may dominate productivity effects, resulting in a depreciation of the exchange rate and a modification of production structures favouring the sectors exposed to foreign competition this is the result generally expected from structural adjustment policies. If, however, production externalities effects are significant and counteract the price and demand effects, real exchange rate depreciation is no longer assured. Furthermore, even if the depreciation occurs, it is possible that this relative price change will not provide a sufficient impetus for economic restructuring.

If the decrease in government expenditure primarily induces a contraction in the tradable sector, the economy will only benefit from a fall in the real exchange rate if the decline in the supply of the public good does not result in an excessive contraction of the export producing sector, i.e. if the public good generates weak externalities. On the other hand, if the impact of the externality is substantial, supply in the export sector will deteriorate because of the budgetary policy. Consequently, this simple model allows us to illustrate the conclusions of the aforementioned studies by showing that an improvement in the relative price structure (favouring the prices of export goods) resulting from a decrease in government spending may be accompanied by a contraction in the sector producing tradable goods, owing to the inadequacy of government services.

If the decrease in public spending primarily entails a contraction in the non-tradable goods sector, and if the impact is substantial, then the real exchange rate may appreciate despite the fall in demand. Private demand cannot be redirected to domestic supply since this latter has contracted while the production of tradable goods does not increase because of the fall in its relative price. We would consequently witness an increase in the external deficit.

This preliminary analysis reveals that **the mechanisms activated by budgetary cut-backs may vary if we assume that government expenditure creates production externalities on different sectors, and it demonstrates the possible existence of incompatibilities between a tight fiscal policy and the required modification of the economic structure**. Nonetheless, so far we have assumed that budgetary restraint only affects intermediate consumption, which in turn generates public intermediate goods. The public payroll however constitutes a large share of government budgets and remains, in many countries, practically the only instrument of stabilisation, given that other expenditures have already been reduced considerably. Consequently, it is of some importance to examine government employment policies and their possible effects on economic adjustment.

III. Government Employment Policies, Production and Unemployment

In order to analyse the impact of layoffs or salary cuts in the public sector, we shall adopt the framework of a dual economy with unemployment (Harris-Todaro model). Developing countries are, in fact, characterised by underemployment of the labour force and by the coexistence of two zones of economic activity one modern, essentially urban, comprising the government and import-substitution producers, the other traditional and consisting largely of producers of agricultural exports and an informal sector producing non-tradable goods.

When layoffs affect a large number of individuals providing unproductive services the increase in the unemployment rate results in a decline in real income and a depreciation of the real exchange rate, reducing the expected real modern wage and inducing a reverse migration of labour toward informal and rural activity. **As the traditional wage falls, the production of export goods increases. bsequently, the trade balance improves owing to the fall in demand for imported goods and the increase in exports** due both to the depreciation of the real exchange rate and the fall in the wage bill in the traditional zone of activity.

If government layoffs result in a dismantling of public services such that the entirety of the private sector is affected, then the decline in real income and in unemployment will be greater. While the production of importable modern goods and of non-tradable traditional goods is sure to decrease (the negative impact of the decreased availability of the public good is exacerbated by the fall in demand, which is greater for this sector than under the previous scenario), the lower wage rate in the traditional sector attenuates the impact of the reduced supply of the intermediate public good for the traditional export sector. As before, the migration of labour is toward the traditional zone ; its level is however greater because of the fall in production in the private modern import-competing sector.

Clearly, if the export producing zone is to be less affected, the supply of public intermediate goods targeted at the modern zone of activity should be reduced more. Conversely, as in the

preceding section, **if an appreciation of the real exchange rate results from the fall in the production of non-tradable goods, then the domestic competitiveness of the tradable sectors may decline and conditions will be less favourable for a better trade balance.**

Civil service layoffs are politically difficult to implement. Payroll reductions, which have often become unavoidable, often take the form of late payment (wage arrears) or, when political feasible, wage cuts. In some cases, such as Cameroon, these pay cuts have been substantial. In these cases we often observe a sharp fall in the productivity of bureaucrats and high level of absenteeism as they take second jobs in order to maintain a minimum income level. The provision of public services becomes disorganised and sporadic.

The contraction of the government payroll results in a drop in income and hence in demand. Like laying off productive civil servants, cutting wages results in decreased provision of public services resulting in a negative shock to production. As this decline in the wage rate carries over to the rest of the modern sector, i.e. the private import-competing sector, however, this latter benefits from the lower cost of manpower and thus increases supply and hires workers.

In order to simplify and better delineate the induced changes in the labour market, assume that the fall in wages does not alter the productivity of civil servants and, consequently, that it is equivalent to laying off low-productivity public employees. We see that the " tradable " modern sector is in a position to grow (because of the decline in the urban wage rate), and a fall in the rate of modern-sector unemployment may follow. Henceforth, labour's remuneration in the zone of traditional activity is simultaneously driven down by the decline in the modern salary and up by the fall in the urban unemployment rate. These two opposing forces determine the evolution of the "tradable" traditional sector. If we assume, however, that hiring of the unemployed by the modern sector is relatively limited and that, as a consequence, there is a net movement of labour into the traditional zone, production of exports of agricultural goods may increase. As to the traditional sector of non-tradable goods, these opposing movements in the modern wage and in unemployment have an indeterminate impact on demand, and we cannot be sure what the net effect on prices will be. **Thus, even if the evolution of the real exchange rate is unclear, it is very likely that the decrease in the modern salary will benefit the "tradable" sectors, both modern and traditional, and not only the traditional sector as was the case under government layoffs**.

This theoretical framework may elucidate some of the effects of labour intensive projects funded by international financing agencies and targeted primarily at combating unemployment. These programs are primarily designed to realise the social policy goals of alleviating poverty, being counter-cyclical instruments intended to stimulate demand in poorer regions or in periods of slow growth. For example, road maintenance projects are favourites as they are very labour intensive. Since their main goal is job creation, they basically consist of paying individuals with no resources to perform low-productivity work. If we assume that these projects target the unemployed, and benefit production, in the urban zone, then our model reveals that the impact may reach beyond stimulating demand and lowering the urban unemployment rate to induce a contraction of the agricultural export sector and an appreciation of the real exchange rate. The net result is thus a deterioration of the trade balance and a loss of domestic competitiveness in the "tradable" sectors. These effects may be mitigated if the aid is directed at supplying infrastructure benefiting the tradable export sectors.

IV. Conclusion

In emphasising the productive nature of some government expenditure, this analysis has focused on the implications of political decisions to reduce civil service employment or the supply of public goods. Even though the general equilibrium framework we have adopted does not allow us to consider the lags between initial, short-term recessionary effects due to the decline in government absorption and its medium-term negative effects on sectoral supplies, we conclude that budgetary policy may constitute an important instrument of

structural adjustment, and not solely of stabilisation. In fact, **even when the fall in domestic demand induced by a contraction of the public sector causes the real exchange rate to fall, it is possible that the production of tradable goods will decline, contrary to the objectives of structural adjustment programs**. Furthermore, an appreciation of the real exchange rate is clearly possible when the production of non-tradable goods suffers from the diminished supply of public services. There exist effects which, though secondary, are no less real, and which should motivate a re-examination of the issue of the impact of government cut-backs on the adjustment of the real economy.

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Fiscal and Tariff Transition and Income Distribution in Developing Countries

The primary changes which developing countries have been required to make to their fiscal policies involve reducing revenue generated by trade and increasing revenue generated domestically (This article is a summary of the presentation given bu D. Cogneau at the "Journée des Economistes de l'ORSTOM 1996".). This reform involves revising the rate structure, eventually expanding the domestic tax base, and finally improving the overall efficiency of the tax system (i.e. combating fraud). As it occurs in the context of structural adjustment programmes, we expect it to yield increased economic efficiency, especially owing to an improved allocation of resources and international specialisation. Furthermore, providing that these changes are successfully implemented, an improvement in the government's fiscal position resulting from increased revenues will permit an increase in productive public expenditure. The goal here is not income redistribution, as in the case of tax reforms undertaken in industrialised countries in which the very structure of domestic taxation (income taxes, value added taxes, etc.) is re-evaluated. **In most cases, the fall in revenues from foreign trade is compensated by an increase in indirect revenues from domestic production and consumption, notably value added taxes. Nevertheless, this fiscal-tariff transition has important implications for the distribution of income, which vary depending on the nature of both the reform and the economies and societies to which it is applied**.

The author of this article hopes to make some contributions of both a theoretical and an empirical nature, drawing on international economics, the dependent economy model, and welfare economics, though it is recognised that this treatment is far from exhaustive. First, we shall examine the budgetary and financial consequences of fiscal and tariff reform, and then their impact on prices and income distribution. Two case studies which were modelled under general equilibrium, dealing with the income distribution implications of the UDEAC (UDEAC is the French initials for the Central Customs and Economic Union.) reforms in Cameroon, and the consequences of trade liberalisation in Morocco, are presented in a box.

I. The Fiscal-Tariff Reform Transition and its Budgetary and Financial Consequences

Budgetary Consequences

We define the fiscal-tariff transition as a decline in tariffs which is either totally or partially compensated, in terms of government revenues, by an increase in indirect taxes (VAT or other) on products (including, of course, imports). This total or partial compensation is particularly justified in countries which have already experienced a drastic adjustment of government expenditures, and where it may be said that these expenditures have attained a floor.

Ceteris paribus, the extent of the required compensating adjustment to indirect taxes is obviously inversely related to the size of this tax base relative to the import sector. An economy with a very large informal sector will see the formal sector absorb a disproportionately high tax increase. Under these circumstances the reform faces a serious risk of failure, as the formal economy, subject to an exorbitant tax rate and facing stiff competition from imports and from the informal sector, may well disappear into the latter. An increase in fraud, a decrease in tax revenues and a budgetary crisis may all follow, so that tariffs retain their dominant position in the government's budget (this was the case in Madagascar and, to a lesser extent, in Cameroon during the reform of the UDEAC zone in 1994). Re-establishing budgetary balance inevitably necessitates adjustments on the expenditure side. **In this case, only by extending the tax base to the informal sector can the transition be realised efficiently**. The cost of broadening this reach is, however, difficult to estimate, and its distributive impact is probably quite inequitable, as it consists of taxing

products (food and the output of cottage industries) consumed by the poorest members of society.

Changes in the Real Exchange Rate

Economic agents consume three types of goods: imports, products of the domestic formal sector, and the output of the domestic informal sector. Prices in these three categories are affected differently by fiscal reform : imported goods are subject to tariffs as well as to sales taxes, goods produced in the formal sector are subject only to the latter, while informal sector output is exempt of all taxes. If the decrease in tariffs is sufficiently pronounced, and if domestically produced goods are only imperfect substitutes for imports, then the reform will result in consumers facing import prices which are lower relative to those of formal and informal domestic goods (We abstract from the issue of smuggling, assuming that legal imports are marketed by the formal sector. In other words, we assume that contraband is neither subject to tariffs nor taxes, while legal imports are subject to domestic taxation.).

Ex ante, we see that this transition has an impact equivalent to an appreciation of the real exchange rate. This is why it is often accompanied by a compensating devaluation of the currency (for example, trade reforms in the customs union undertaken in 1994) to re-establish long-run equilibrium. Often, even in the framework of regional free-trade agreements (NAFTA, the EU-Morocco and EU-Tunisia trade agreements), the increased penetration of imports is much greater than the growth of exports, owing to the asymmetric nature of trade liberalisation tariff barriers being much higher in the South than in the North. Since a primary goal of the transition is to attract foreign private investment (direct investment), however, it should, if it is successful, eventually result in a stabilisation of the real exchange rate. An influx of foreign public capital (aid or loans) may also accompany the reform and serve to temporarily balance the foreign account (These financial flows are, however, compensated in the long-run by flows in the opposite direction repatriated profits and debt repayment.).

The Danger of Macroeconomic Destabilisation and the Political Economy of Transition

It is of some importance not to minimise the potentially destabilising impact of tariff reform, especially when the macroeconomic management capabilities of the government are weak and when significant productivity gains in the tradable goods sectors are not envisaged (required for increased competitiveness and attracting foreign direct investment). This danger of destabilisation is all the greater when the microeconomic efficiency improvements and growth resulting from liberalisation will be minimal.

The recent example of Mexico speaks volumes on this matter persistent balance of payments problems combined with a lack of confidence from outside investors to precipitate a crisis and force drastic adjustments. Mexico, being a large country, is not particularly vulnerable in matters of external debt and budgets, as its openness to the outside is relatively limited and its domestic fiscal situation is more developed than those in the countries of the Maghreb or sub-Saharan Africa.

Rodrik (1996) reminds us to what extent the trade liberalisation of the countries of East Asia and South-east Asia was a gradual process, and that this was preceded by measures to reinforce governments' macroeconomic management capabilities and by a rapid accumulation of factors of production (physical and human capital). In contrast, some Latin American countries have had to accomplish in five years what Asian countries did in over twenty years. It is of particular interest that Rodrik attributes the better "governance" and management capacity of Asian countries to an initially more egalitarian distribution of wealth (which, in addition, creates conditions favourable to a rapid accumulation of human capital).

Let us examine in more detail the gains, and their distribution, in microeconomic efficiency attributable to tax and tariff reform in order to assess how it impacted on income distribution.

II. Expected Price and Income Effects

Income Redistribution in the Traditional Framework

Standard general equilibrium models usually provide poor estimates as to long-term microeconomic efficiency gains generated by trade liberalisation, on the order of two to three percent of GDP on average(Brown et al. (1994), Golding et al. (1993), Robinson (1991) and Rutherford et al. (1995). For the Maghreb and sub-Saharan Africa some estimates are lower, even negative (cf. Goldin et al. (1993) for the impact of the Uruguay round on these regions, for example).).

Traditional economic theory predicts that trade liberalisation will stimulate specialisation in sectors using factors of production which are relatively abundant in the case of developing countries these are natural resources and unskilled labour. The growth in productivity of these inputs induced by the migration of mobile factors into these sectors allows their remuneration to increase relative to that of capital and skilled labour. This line of reasoning suggests that the distribution of income should improve as a result of trade liberalisation as unskilled labour and peasants benefit. However, the case of land is particular. When agricultural imports from developed countries compete head-on with local produce, the ensuing fall in prices hurts land-owners while benefiting non-producing consumers. Incomes of individuals living only on rental income falls. Thus, even if the increased specialisation of the economy in areas of comparative advantage benefits small farmers, the final effect on their incomes of liberalisation is indeterminate, and may be negative. Within this standard framework, **the evolution of the income of poor peasants far from the market appears to form the crux of the distribution issue**. If this seems to be a burning issue in Mexico (corn growers, peasants in the Chiapas), how much more might this be a concern in the Maghreb or in sub-Saharan Africa.

Redistribution over Prices in the Traditional Framework

On the other hand, these effects on relative incomes may be compensated by price effects. The various classes of consumers (capital owners, skilled labour, unskilled labour, rural, etc.) do not all share the same consumption bundle and hence have different cost of living indicators. The wealthiest citizens, whose bundles contain more imports, tend to benefit from the tariff reduction. However, the compensating increase in indirect taxes, applying to the formal goods, doubtlessly affects the same groups. Furthermore, the fall in the price of food imports may benefit the poorest (cf. the case of Cameroon). The governing factors here will be, on the one hand, the distribution in consumption of imported goods affected by the reform and of the products of the formal sectors (which constitute the base of indirect taxes) in broad terms, their relative income-elasticities and, on the other hand, the substitution elasticities between these two types of goods. At one extreme, when formal sector products are very similar to imports (a high degree of substitutability), their prices fall in tandem with those of imports. Consumption bundles comprising a large share of these goods clearly benefit. However, in this case it is difficult to realise the anticipated budgetary compensation. At the other extreme, if imported consumption goods are complements to formal goods, the increase in price of these latter will counteract the fall in price of imports in the consumer's bundle. If the shrinking of the domestic tax base is sufficiently small and the increase in the rate sufficiently big, the final impact of the reform on the redistribution of the cost of living may prove to be equitable (cf. the case of Morocco).

All things considered, the income redistribution resulting from relative price and cost of living movements should be limited in the majority of cases. Estimates for Cameroon and Morocco confirm the dominance of income effects over price effects.

The pattern we have been examining associates a major redistribution of wealth with a fairly modest increase in overall efficiency. Rodrik (1996) coined the term "political cost-benefit ratio" to describe this concept. This far-reaching income redistribution is further associated with an extensive sectoral reallocation of factors (movement of specialisation).

Naturally, there exist arguments in favour of free-trade which are not based on the standard models, and which vaunt its distributive virtues :

- ¿ Sectors with a comparative advantage may show increasing returns to scale such that the opening to international trade yields access to huge markets and spurs much more significant productivity, and hence wage, gains.
- ¿ The monopoly or oligopoly power of previously protected domestic producers may be reduced in the markets of tradable goods, limiting the earnings of capital owners.
- ¿ The output of exportable commodities may benefit from the increased availability of imported inputs or from the growth in exports. If these externalities allow for capital to be saved and decrease its relative remuneration, we may have a desirable redistribution alongside an efficiency gain.
- ¿ Trade liberalisation may encourage positive expectations in foreign investors, resulting in a decline in the risk premium on capital inflows. The accumulation of foreign capital will tend to drive down profit rates and the return to capital, and may yield benefits for skilled labour, a complement to capital, thus benefiting the well-off rather than the poor.

Even if the benefits of trade liberalisation include, among others, simplicity and prudence, its effectiveness remains however the subject of debate. The strongest argument against surely arises from models of endogenous growth. **Nothing guarantees that the sectors of comparative advantage will be the growth sectors, benefiting, for example, from technological externalities or learning by doing**. If these two sectors do not coincide, then there exists an optimal system of tariffs, as the "new international economics" has shown. **When trade liberalisation diverts resources (capital, labour, etc.) from growth sectors, efficiency gains and redistribution may occur at the expense of long-run growth**. Short-term increases in welfare may then forfeit long-term welfare growth. Current trends in direct investment from the North into the South appear to target technological sectors or sectors with dynamic domestic markets (high income-elasticity, for example), and are concentrated in countries with substantial human resources and expanding markets (primarily Asia). **Consequently, it may be dangerous for developing countries to excessively promote specialisation in the traditional sense**. From a distributive perspective, at least, the growth sectors named above are probably less intense in labour, or in other resources which are fairly equally distributed, than some of the sectors of comparative advantage. Of course, it may also be deemed inequitable to indefinitely maintain a system benefiting a handful of sheltered firms and their employees if accumulation and growth are not forthcoming.

III. Conclusion

For the tax and tariff reforms undertaken by most African countries to succeed without causing a major macroeconomic destabilisation, it is not only necessary that the domestic tax base be enlarged and that the governments have solid macroeconomic management capabilities, but also that these reforms be accompanied by productivity gains and a significant pace of factor accumulation.

As a rule, the estimates of the long-term, microeconomic efficiency gains of free trade derived from general equilibrium models are rather modest. Trade liberalisation should however be accompanied by a significant redistribution of income. In Africa, the core of the distribution problem apparently concerns the small food farmers, for whom the impact of the fiscal and tariff transition remains uncertain.

Empirical General Equilibrium Analysis using a Micro-Macro Model

The models used here to analyse the tax and tariff reform transitions in Cameroon

and Morocco are based on an maquette from Bourguignon, Branson and Melo (1991), designed specifically to study distribution effects in developing countries implementing stabilisation and structural adjustment policies. This dynamic framework accounts for both short-term macroeconomic stabilisation issues through the inclusion of a monetary and financial module, and for longer-term structural phenomena such as reallocation and growth. We will not discuss the characteristics of these models here, except to recall that they account for some rigidities in the economy: rigidity in the technology of production, imperfect substitutability between imported and domestic goods, rigidity in the formal-sector labour market, urban unemployment and the existence of segmented markets connected by migration and limited socio-professional mobility, and the oligopolistic character of formal enterprises (industry and services).

The Tax and Tariff Reform of the UDEAC Zone in Cameroon: Marginally Negative Distribution Effects

The tax and tariff reform undertaken in 1994 and 1995 created the following nominal tax rates: a 35% decrease in import duties on agricultural produce, industrial output and on complementary imports, combined with indirect tax increases on wood and industrial output (+50%) on building and public works (+33%) and on services (+20%). Assume that tax fraud does not increase owing to the tax increases, and that formal companies do not lose market power because they adjust by cutting their utilization of production capacity and labour. We then observe that the transition does not appear to erode the return to capital or wages in this sector, but that unemployment increases. The slight reduction in the budgetary deficit resulting from the reform reduces the crowding-out effect on private investment and increases the demand for building and public works. This particularly benefits non-agricultural rural households living in typical small towns as well as potential migrants into the two main cities. Finally, competition in the foodstuff markets depresses their prices and the income of peasants. This fall in prices of agricultural produce has two consequences: a fall in the cost of living of the poorest, but also a decline in incomes for peasants. The increase in agricultural exports induced by the reallocation of agricultural labour is not sufficient to compensate for the lower revenues, and real incomes of farmers decline. On the other hand, the lower price of food benefits labour in the informal sector of small towns (rural non-agricultural). Both from the perspective of efficiency gains as well as for income distribution, the consequences of the reform appear slightly negative.

Trade Liberalisation in Morocco: A Substantial Decline in Social Inequality Without a Marked Reduction in Poverty

In the case of Morocco, we examine the hypothesis of the extreme case of the total abolition of tariffs (complete free-trade). Notice that this does not actually reflect the agreements recently signed with the European Union, which apply neither to agriculture nor to the rest of the world. In a sense, our hypothesis combines the consequences of this agreement, extended to agriculture and non-European trading partners (who represent one third of Morocco's foreign trade by destination) with those of Morocco's adhesion to the WTO (the Uruguay round was concluded in Marrakech).

The distributive consequences of the trade liberalisation appear considerably more positive than was the case in Cameroon. The greater flexibility of the Moroccan economy allowed sectoral reallocation to play its distributive role. We observe a significant decline in inequality, but a lesser decrease in the poverty indices. Groups whose income depends upon agriculture benefit the most. However, large-scale farmers' experience the greatest rise in incomes, as the increased demand for

agricultural exports drives up the return to land. As to agricultural wages, reverse migration from the cities to the countries has a moderating effect. Modern workers, more skilled and better paid initially, suffer from the decline of branches of industry which do not have a comparative advantage. Capitalists, the principal owners of formal capital in these branches, sustain an even greater loss of income. Finally, reverse migration and a more sustained demand for building and public works for investment purposes drive up the salaries of urban informal labour. Cost of living variations for the different groups also contribute to the redistribution of welfare, imports being more broadly spread among the consumption bundles and the VAT affecting primarily the urban groups. In sum, the transition seems to have beneficial distributional consequences in terms of equity. Notice, however, that among the two poorest groups in the population, informal urban labour and agricultural wage-earners, only the former experienced a significant improvement in their living conditions.

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