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Towards a New Understanding of the Economic Liberalization Philosophy

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Abstract: The liberalized regime in any economy aims to perform three functions: the mobilization of saving (the pooling effect), the allocation of saving to the investment projects (the allocation effects) and the facilitation of payment system operations (operational effect). These functions impact tremendously the developmental trend of the economy and impact its consequences both at short and long terms. In this context, the issue of which channels allow the bank to perform best their allocation mechanisms of the saving towards the profitable investment is a controversial one as the question is currently asked about whether the state or the market oriented perspective is more able to adjust rationally between the allocation costs and its revenues. This paper tries to highlight the steps of the market oriented perspectives on the efficiency system and their impact on the economic prosperity.

Keywords: Liberalization, Efficiency, Development

1. Introduction

The issue of efficacy of the state involvement or the market based approach in performing the banking function had been a subject of an intense debate. The proponents of the market perspective advocate the necessity to let the banks work according to the market (supply and demand) law. This proposition according to them is capable to ensure the efficiency of the banking system in dealing with its different operations. It is also a procedural mean to increase the profitability of the banks as the credits are generally directed towards the highly advantageous and competitive projects. As opposed to the market theorists, the state protagonists call for the obligation of the state intervention in the banking system. The reason behind this assumption is that the market is not completely capable to ensure the competitiveness and the efficiency. This market incapacity comes from the distortions that may occur between the agents transacting in the market, and the failures of the market itself in transmitting the necessary information between the agents. The second motive for the state involvement in the banking sector is the existence of strategic and priority sectors in the economy must to be financed at first. This opportunity is not possible without the high height of the state in the economy. The third reason is that the state is the only capable and responsible agent to maintain the fairness and the equality of the income distribution between the economic agents in the society; the market in this sense inhibits some agents to benefit from the externalities of the economic growth (state-social welfare paradigm).

2. Liberalizing the Financial Sector: One Process but Different Implications

The genesis of the financial liberalization theory dates back to the works of McKinnon (1973) and McKinnon and Show (1973). They suggest that the repression measures applied in the economy are tremendously harmful to the smoothly functions of the economic agents and their struggle to come up with their goals. The core idea behind this assumption is that the state or the *statism* philosophy is not capable alone to establish a fair environment of competition and efficiency as the behavior of the economic agents under the tight control of the state is not rationally managed. The corrective measures to the state deficiency consist of letting the market takes the responsibility of organizing the behavior of the economic agents according to the principles of cost-benefit and efficiency-competitiveness. The market based approach tends to decrease the transaction costs between individuals and repair the failures of the resource allocation mechanisms. The contrasting views between the two strands leads inevitably to the emergence to the managed liberalization which means the coexistence to some extent of the two philosophies: the market and the state based approach. The managed liberalization comes to respond simultaneously to the market failures and the irrational allocation mechanism. Moreover, this issue entails the necessity to conceive the appropriate management style of liberalization that reaches the following objectives:

a. The improvement of the quality of the assets held by the bank as the state intervention in the banking operations leads to reduce the diversification of assets and the downgrading of the credit supplied.

b. The system of the managed liberalization process reduces the intensified allocation of the credits towards the state, the fact that diminishes the private sector investments.

c. The liberalization amplifies the desire to improve the state financial system. This improvement is necessary to face the competitive forces of the market.

d. The managed liberalizing system tends to increase of liquidity of the government bonds. Under the tight control of the state, the government bonds are highly concentrated which leads to diminish their liquidity ratio.

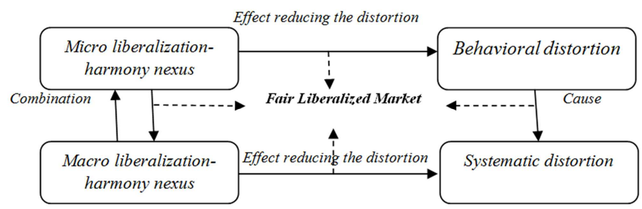
e. The increase of the interest rate and default risks distribution between public and private banks as under the state system only the public banks bear the responsibility to manage these risks.

f. The rational maintain of the variables that conduct the monetary policy. Under the state system generally, the central banks do not establish the rates of credits supply and demand according to the market principle: cost-benefit but according to some other implication beyond the economic sphere (political consideration as an example). This fact leads to bailout the loss of the above principle by creating huge quantities of money which leads at further stages to high rates of inflation.

g. Under the liberalized system, the interest rates are fixed upon the market basis. When the deposit interest is high, the depositors will be more incentivized to put their funds in the banks; the fact that reduces their purchasing power capacity and their consumption in general. The managed system comes to regulate the situation in favor of both the economic aspirations which are related to the financial market per se (lending and deposit interest rates) and the economic aspirations which are related to the macroeconomics and the economic policy (saving - consumption - production - growth).

3. The Managed Liberalized System and the Market Failures

The term of the market failure is designed to show the discrepancies generated by markets between the economic agents in their continual businesses to attain the objectives. These distortions are of two specific kinds: the behavioral distortion and the systematic one. The former occurs when the economic agent suffers a lack of efficient information about the characteristics and the evolution of the business in which this agent operates. As an example of this kind when the agent engages in buying and selling the corporate stocks without a deep knowledge of the issuing corporate patterns and the market responses of this transaction. Thus, it will be strongly probable to this agent to fall in bankruptcy or financial difficulties (lack of business investigation and uncertainty). The second type of distortions comes when the market itself shows phases of irregularities and discrepancies in fixing the right prices and maintaining the social welfare of the individuals. Based on the theory of liberalization, the market constituents (one of its parts is the financial constituent shown here by the banking sector) should to be liberalized to reduce the likelihood of the economic and the social disturbances that may happen when the market is tightly controlled. According to them, the liberalization of the market intensifies the psychological competitiveness of the individuals which leads them fiercely to search for the details of any business project or a transaction. This phase paves the way to the second competitiveness known by the practical competitiveness which is revealed by the rational and the wise usage of the information held by the individuals to realize the best nexus of the cost-benefit analysis. This is not done without the combination of the prediction capacity which is based also on the right information. Therefore, the good dissemination and the sufficient holding of the information between the individuals reduce largely the first kind of the distortion coined by the concept of the behavioral distortion. The management process of the systematic distortion is based entirely on the management of the first type. In this sense, the regulation of the economic agents in their goals and constraints according to the law of the market leads gradually to a complete and global harmony touching the individuals in their market activities (Micro liberalization-harmony nexus) and also the market as an organization (Macro liberalization-harmony). The kinds of the distortions and the harmony needed to manage them are illustrated by the following diagram:



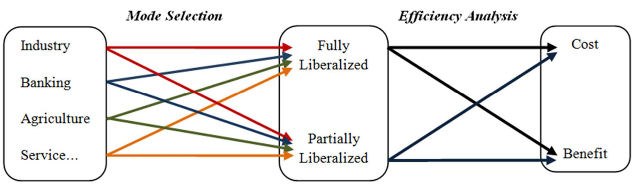
Source: the researcher

Figure 1. *The liberalized regime and the market failures.*

4. The Liberalization System and the Efficiency Target

The ultimate goal of any economic strategy is to establish and maintain over time the efficiency of doing business of all or to the majority of the economic cycle constituents. This objective is achievable only when the system designed responds appropriately to the peculiarities and the conditions of the economic environment in which it is applied. In general, the management theory offers a basic explanation to the efficiency concept as the relative measure between the objectives effectively realized during the stated period and the package of the prescribed objectives. In the context of the liberalization, the process of lifting up all kinds of controls should move in this direction as a strategy to increase the benefits relatively to the costs of each one of the market constituents. This philosophy raises many questions. Among them, the necessity to define after a deep analysis the prior constituents should to be fully liberalized; and the others that – after the study of the economic situation and prospective- should be partially liberalized. Tackling the subject of the liberalization-efficiency nexus advances the ideas towards the establishment of a network that join three columns together:

1. The column of the market constituent: this column holds the economic activities and the sectors that is beneficial for the economy to be either fully or partially liberalized. This first investigation should be preceded by a clear and deep analysis of the capacities and goals of the sector and its real contribution to enhance the economic growth (measuring the sector position vis-à-vis the others in the economy).
2. The column of the liberalization modes: in this part the cases and the conditions of each one of the liberalization modes are illustrated. Moreover, the phases of the liberalization not as a philosophy but as a strategy are cited, as an example: the liberalization of the interest rate, the domestic financial liberalization, the stock market liberalization, the capital account liberalization…
3. The column of the efficiency: this column grips the principle of the cost-benefit nexus. The issue of which sector or activity should to be liberalized and the mode to apply is analyzed according to the actual and prospective advantages and disadvantages. In this sense, each sector is matched to its appropriate mode of liberalization and its corresponding cost-benefit nexus as it is shown by the following diagram:



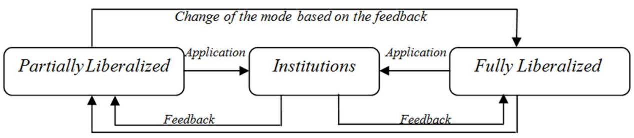
Source: the researcher

Figure 2. *The Liberalization-Efficiency network.*

5. The Impact of the Sequencing Liberalization Process on the Efficiency of the Economic Sectors

In this context, two approaches of liberalization are suggested and applied: the sequencing approach and the big bang one. The former approach means that the process is undertaken between the sectors of the economy gradually. This is done according to the current and the prospective situations of the economy. The gradualism of the liberalization is started by liberalizing the internal sectors that constitute the economy, and then the external sectors will be liberalized cautiously. The latter sequence is adopted only when the economy is well positioned vis-à-vis the other economies in terms of production, trade and competitiveness.

The second type of the liberalization process is known by the big bang approach. It means to free up the controls on the economic activities abruptly without establishing a scale of priorities or a way of organization. This second type is somewhat dangerous as it does not take into consideration the capacity of the various sectors of the economy to absorb the new patterns of running business under the liberalized regime. In this sense, it is advisable to the economy to take a sufficient time of analysis and investigation before engaging definitely in this kind of liberalization. The reason behind this assumption is that the sectors and the activities are different in their development and competitiveness. This diversity in the trend of the development implies that some sectors adapt conveniently with the requirements of the liberalization and benefit from its outcome, and the others which are below the efficiency benchmark relative to the liberalization suffer from the ideology of the autonomy and the decontrol applied under the liberalized regime. The issue here remains to find the suitable sequential trend to adopt in such a way that enhances the economic and competitiveness capacity during the interval of the process. This implies that economic strength is considered as a feedback to increase the benefits of the liberalization process whether it is partially or fully undertaken. In this context, it is worthwhile to mention that is possible to alternate between the two kinds of the liberalization in accordance with the economic levels of development. This alternation is based on what the economy wants from the degree of the liberalization process as well as the institutional power of its organizations. This liberalization feedback based on the institutional strength is shown by the following figure:

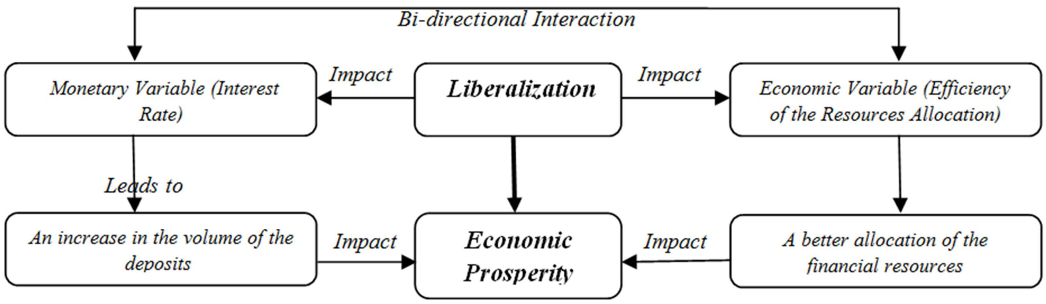


Source: the researcher

Figure 3. *The change of the liberalization mode and the impact of the institutional feedback.*

6. The Financial Liberalization and the Financial Efficiency (Credit Allocation)

The financial liberalization has a prevalent effect on the credit allocation via two routes: the monetary route and the economic one. The former means the impact of the changing movement of the monetary variables the conduct the trend of the credit supply. The basic monetary variable that plays the prominent role in the movement of the credits is the interest rate. The second route implies the relationship between the credit and the investment. It means the impact of the financial liberalization in cleaning the irregularities attributed to the market. These irregularities: the moral hazard and the adverse selection. These two situations put a damper on the well functioning and the smoothly behavior of the market in channeling the resources towards their best uses. In this sense, the liberalization of the interest rate for both the deposit and the lending behaviors increases the incentives of the individuals to put their money in the financial institution as a result of the increase of the interest rate. This augmentation comes from the interaction of supply and demand forces of the financial claim in one hand; on the other, from the scarcity effect. The resultant policy of the high interest rate breaks down almost completely the problem of the financial constraints which obstructs the investment activities. The second positive effect comes to decrease the market distortions that deprive the profitable investment projects to benefit from the necessary financial resources. This misallocation of resources enlarges the fissure between the monetary and the economic consideration and leads to an overall economic disturbance. The following square shows clearly the interactions between the monetary and the economic considerations under the liberalized regime:



Source: the researcher

Figure 4. *The square of liberalization-Economic Prosperity.*

7. Conclusion

This paper tries to shed light on the philosophy of the liberalization and its impact on the economic development through the market, the efficiency and the financial liberalization channels. By this sense, the economic liberalization has different positive externalities on the other economic institutions only if the efficiency of the liberalized regime is maintained. In addition to this, the interaction between the monetary and the economic variable is a necessary condition to strengthen the efficiency machine and to gain at maximum from the liberalized regime.

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