

# Chapter 11

## Development Policymaking and the Roles of Market, State, and Civil Society

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# Economic Development

11th Edition

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# 11.1 A Question of Balance

- Roles and Limitations of State, Market, and the Citizen Sector/NGOs in Achieving Economic Development and Poverty Reduction
  - National governments have played an important role in the successful development experiences in East Asia.
  - While in Africa, Latin America, the Caribbean, and some transition countries, government often appears to have been more of a hindrance 阻碍 than a help.

## 11.2 Development Planning: Concepts and Rationale

- The Planning Mystique 计划的神秘性
  - In the past, few doubted the importance and usefulness of national economic plans
  - Recently, however, disillusionment 理想破灭 has set in
  - But a comprehensive development policy framework can play an important role in accelerating 加速 growth and reducing poverty

# 11.2 Development Planning: Concepts and Rationale

- The nature of development planning resource mobilization for public investment
  - Economic policy to control private economic activity according to social objectives formulated by government
  - Comprehensive plan v.s. partial plan
- Planning in mixed developing economies
- Private sector in mixed economies comprises
  - The subsistence sector
  - Small scale businesses
  - Medium size enterprises
  - Larger domestic firms
  - Large joint or foreign owned enterprises

# 11.2 Development Planning: Concepts and Rationale

- The Rationale 合理性 for Development Planning
  - Market failure
  - Resource mobilization and allocation
  - Attitudinal 态度 or psychological 心理 impact
  - Requirement to receive foreign aid

# Three General Forms of Market Failure

- The market cannot function properly or no market exists
- The market exists but implies inefficient resource allocation
- More expansively: the market produces undesirable results as measured by social objectives other than the allocation of resources
  - Often items such as more equal income distribution, and “merit goods” such as health, are treated as separate rationales for policy, outside of economic efficiency

# Market Failure

- Market failures can occur when social costs or benefits differ from private costs or benefits of firms or consumers
- Market power (monopolistic, monopsonistic)
- Public goods: free riders cannot be excluded except possibly at high cost
- Externalities: agents do not have to pay all costs of their activities, or are unable to receive all the benefits
- Prisoners' Dilemmas occur when agents better off if others cooperate but individual agents better off "defecting"
- Coordination failures can occur when coordination is costly; e.g. with Big Push problems (Chapter 4)
- Capital markets are particularly prone to failure

# Market and Government Failure: Broader Arguments

- Government failure: in many cases, politicians and bureaucrats 官僚 can be considered utility maximizers, not public interest maximizers
- So can't jump to conclusion that if economic theory says policy can fix market failures that it will do so in practice
- Analysis of incentives for government failure guides reform, e.g. civil service reform, constitution design
- Developing countries tend to have both high market failure and high government failures

## 11.3 The Development Planning Process: Some Basic Models

- Characteristics of the planning process
- Planning in stages: basic models
  - Aggregate growth models
  - Multisector input-output, social accounting, and CGE models
- Three stages of planning
  - Aggregate 总体
  - Sectoral 部门
  - Project 项目

# Aggregate Growth Models (1)

## Projecting Macro Variables

$$K(t) = cY(t) \quad (11.1)$$

Where  $K(t)$  is capital stock at time  $t$

$Y(t)$  is output at time  $t$

$c$  is the average and marginal capital-output ratio

## Aggregate Growth Models (2)

$$I(t) = K(t+1) - K(t) + \delta K(t) = sY = S(t) \quad (11.2)$$

Where

$I(t)$  is gross investment at time  $t$

$s$  is the savings rate

$S$  is national savings

$\delta$  is the depreciation rate

If  $g$  is the targeted rate of output growth, then

$$g = \frac{Y(t+1) - Y(t)}{Y(t)} = \frac{\Delta Y(t)}{Y(t)} \quad (11.3)$$

## Aggregate Growth Models (3)

$$\frac{\Delta K}{K} = \frac{c\Delta Y}{K} = \frac{(K/Y)\Delta Y}{K} = \frac{\Delta Y}{Y} \quad (11.4)$$

$$g = \frac{sY - \delta K}{K} = \frac{s}{c} - \delta \quad (11.5)$$

$$n + p = \frac{s}{c} - \delta \quad (11.6)$$

where  $n$  is the labor force growth rate and  $p$  is the growth rate of labor productivity

## Aggregate Growth Models (4)

$$W + \pi = Y \quad (11.7)$$

where  $W$  and  $\pi$  are wage and profit incomes

$$s_\pi \pi + s_W W = I \quad (11.8)$$

where  $s_\pi$  and  $s_W$  are the marginal propensities  
to save from wage income and profit

## Aggregate Growth Models (5)

- Modified Harrod-Domar growth equation:

$$c(g + \delta) = (s_\pi - s_W) \left( \frac{\pi}{Y} \right) + s_W \quad (11.9)$$

which can then serve as a formula for ascertaining the adequacy of current saving out of profit and wage income.

- If a 4% growth rate is desired and if  $\delta = 0.03$ ,  $c = 3.0$ , and  $\pi/Y = 0.5$ , Equation 11.9 reduces to  $0.42 = s_\pi + s_W$ . If savings out of capital income amount to 25%, wage earners must save at a 17% rate to achieve the targeted rate of growth.

# Multisector Models and Sectoral Projections

- Interindustry or input-output models
- Can be extended in 2 ways
  - Social accounting matrix (SAM) models where data from national accounts, balance of payment, and flow-of-funds databases is supplemented with household survey data.
  - Computable general equilibrium (CGE) models where utility and production functions are estimated and impacts of policies are simulated.

# Project Appraisal and Social Cost-Benefit Analysis (1)

- Basic concepts and methodology
  - Specify objective function (future levels of consumption, income distribution, environmental evaluation)
  - Compute social measures (**shadow prices**): calculating the social rate of discount or social time preference
    - Def.: Prices that reflect the true opportunity costs of resources.
  - Establish decision criterion

# Project Appraisal and Social Cost-Benefit Analysis (2)

- In developing countries, market prices of outputs and inputs do not give a true reflection of social benefits and costs
- Five reasons:
  - Inflation and currency overvaluation
  - Wage rates, capital costs, and unemployment
  - Tariffs, quotas, subsidies, and import substitution
  - Saving deficiency 不足
  - The **social rate of discount** (NPV): The rate at which a society discounts potential future social benefits to find out whether such benefits are worth their present social cost.

# Project Appraisal and Social Cost-Benefit Analysis (3)

- Net present value, or NPV is given by

$$\text{NPV} = \sum_t \frac{B_t - C_t}{(1 + r)^t} \quad (11.10)$$

where  $B_t$  is the expected benefit at time  $t$   
 $C_t$  is the expected cost at time  $t$   
 $r$  is the social rate of discount used

# Project Appraisal and Social Cost-Benefit Analysis (4)

- Choosing projects: some decision criteria
  - NPV rule: the project with the **highest NPV/K** ratio is chosen first, then the next highest, and so on down the line until all available capital investment funds have been exhausted.
  - Compare the internal rate of return with an interest rate
- Conclusions: planning models and plan consistency

## 11.4 Government Failure and Preferences for Markets over Planning

- Theory versus practice
  - **Government failure**: a situation in which government intervention in an economy worsens outcomes.
- Deficiencies in plans and their implementation
- Insufficient 不充分 and unreliable data
- Unanticipated 非预期 economic disturbance 扰动, external and internal
- Institutional weaknesses
- Lack of political will 意愿
- Conflict, postconflict 后冲突, and fragile states 脆弱的国家

# 11.5 The Market Economy

- Well functioning market economy requires
  - Clear property rights
  - Laws and courts
  - Freedom to establish business
  - Stable currency
  - Public supervision 监督 of natural monopolies
  - Provision of adequate information
  - Autonomous tastes 自主偏好
  - Public management of externalities
  - Stable monetary and fiscal policy instruments
  - Safety nets
  - Encouragement of innovation

## 11.5 The Market Economy

- The “Washington Consensus” on the Role of the State in Development and its Limitations
- The consensus reflected a free market approach to development espoused by the IMF, the World bank, and key U.S. government agencies

# Table 11.1 The Washington Consensus and East Asia

Elements of the Washington Consensus	South Korea
1. Fiscal discipline	Yes, generally
2. Redirection of public expenditure priorities toward health, education, and infrastructure	Yes
3. Tax reform, including the broadening of the tax base and cutting marginal tax rates	Yes, generally
4. Unified and competitive exchange rates	Yes (except for limited time periods)
5. Secure property rights	President Park starts his rule in 1961 by imprisoning leading businessmen and threatening confiscation of their assets
6. Deregulation	Limited
7. Trade liberalization	Limited until the 1980s
8. Privatization	No. Government established many public enterprises during 1950s and 1960s.
9. Elimination of barriers to direct foreign investment (DFI)	DFI heavily restricted
10. Financial liberalization	Limited until the 1980s

Source: From "Understanding economic policy reform," by Dani Rodrik. *Journal of Economic Literature* 34 (1996): 17. Reprinted by permission of the American Economic Association.

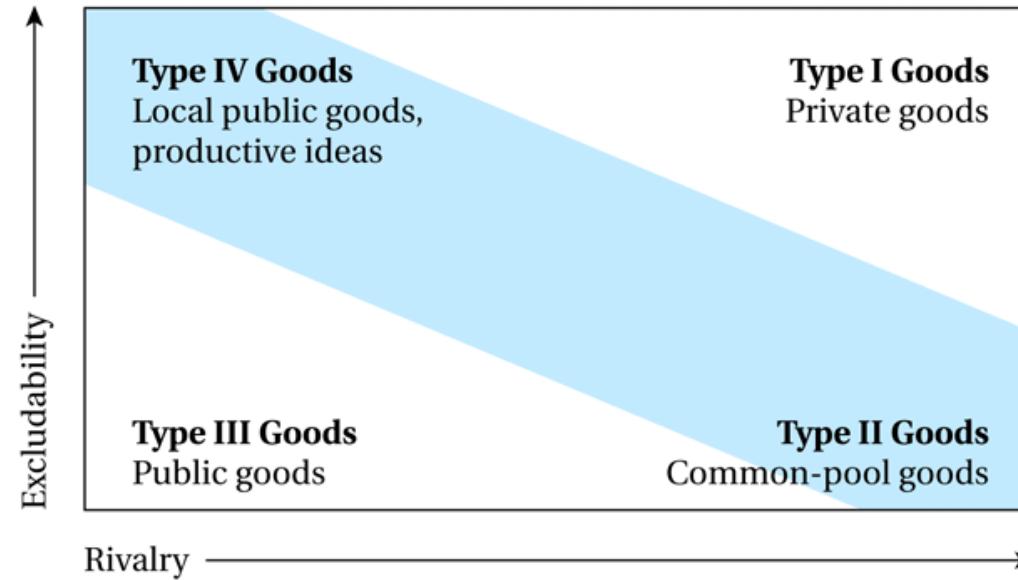
## **11.6 The Washington Consensus on the Role of the State in Development and Its Subsequent Evolution**

- Toward a new consensus
  - New emphasis on government's responsibility toward poverty alleviation and inclusive growth
  - Provision of fundamental public goods
  - Importance of health and education
  - A recognition that markets can fail
  - Governments can help secure conditions for an effective market based economy

## 11.8 Development Roles of NGOs and the Broader Citizen Sector

- Nongovernmental organisations ([NGOs](#))
  - Nonprofit organisations often involved in providing financial and technical assistance in developing countries.
- Potentially important roles in:
  - Common property resource management
  - Local public goods
  - Economic and productive ideas
  - Possibly other activities that are either:
    - Excludable but not rival
    - Rival but not excludable
    - Partly excludable and partly rival

# Figure 11.2 Typology of Goods

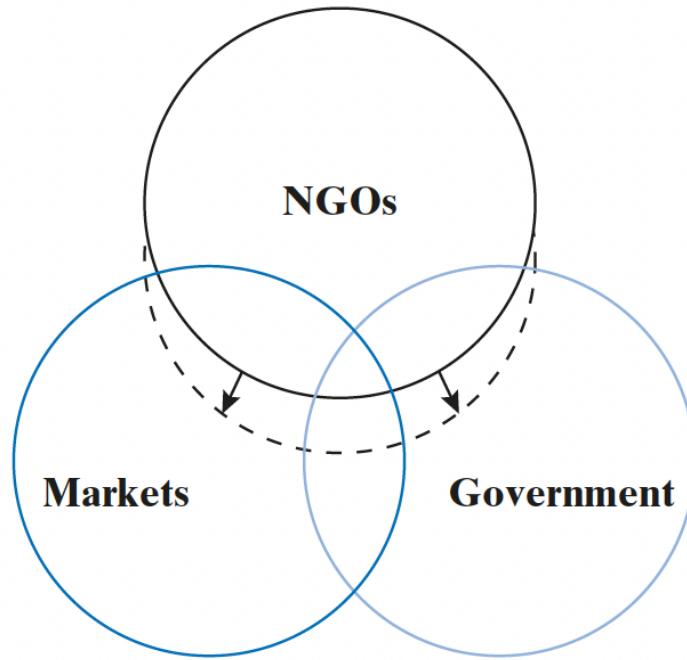


The shaded diagonal indicates the area of primary NGO comparative advantage in dimensions of rivalry and excludability. When, based on local conditions (such as government failure), NGOs are in a position to supply public or private goods at a lower price or higher quality, they may be found expanding into these nonshaded areas as well (Type I and Type III goods).

# 11.8 Development Roles of NGOs and the Broader Citizen Sector

- Other potential comparative advantages of NGOs
  - Innovative design and implementation
  - Program flexibility
  - Specialized technical knowledge
  - Provision of targeted local public goods
  - Common-property resource management design and implementation
  - Trust and Credibility
  - Representation and advocacy 支持

**FIGURE 11.3 Sector Overlap and Sector Extension: Contingency-Based Shifts in Organisational Comparative Advantage, with the NGO example**



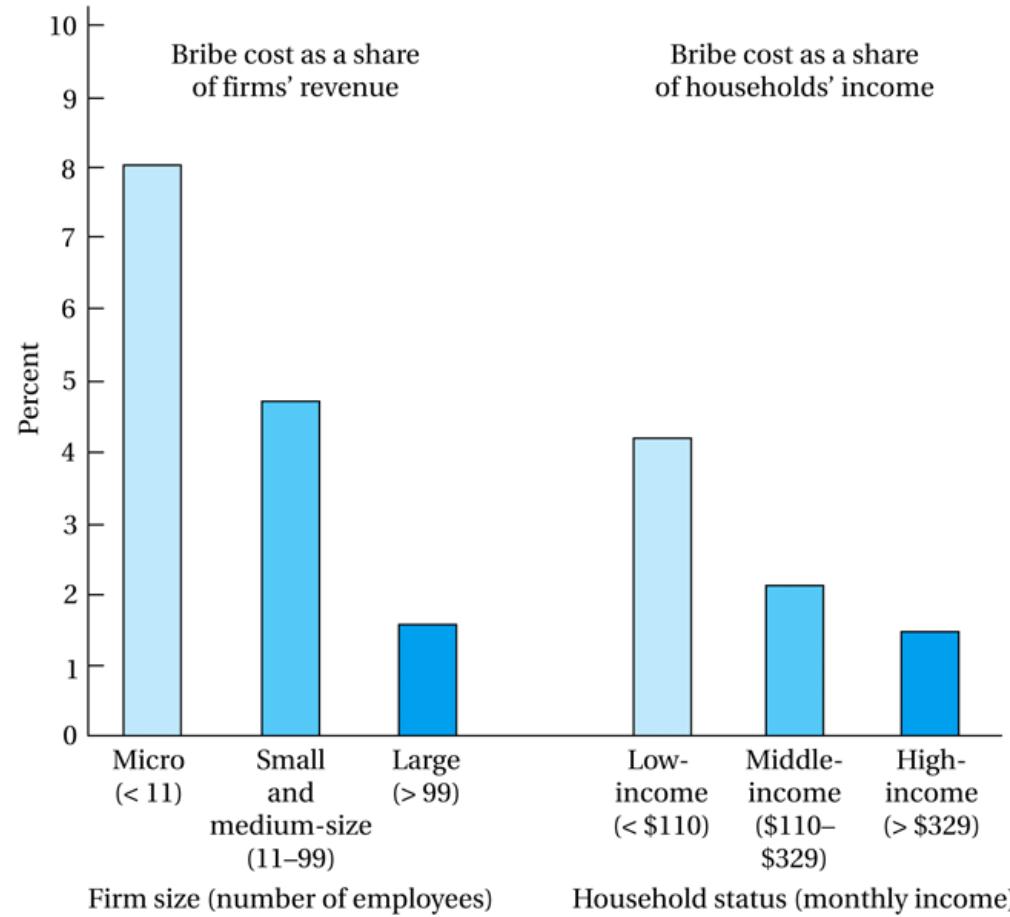
# Other limitations: “voluntary failure” – NGOs may be...

- Insignificant, owing to small scale and reach.
- Lacking necessary local knowledge to develop and implement an appropriate mix of programs to address relevant problems
- Selective and exclusionary, elitist 精英主义, and or ineffective
- Lacking adequate incentives to ensure effectiveness
- Captured by goals of funders rather than intended beneficiaries; may change priorities one year to the next
- Giving too little attention to means, preventing needed scale...
- Or, find that means—such as fundraising—can become ends in themselves
- Lacking immediate feedback (as private firms get in markets, or elected governments receive at the polls); this can let the weaknesses go on for some time before being corrected

# 11.9 Trends in Governance and Reform

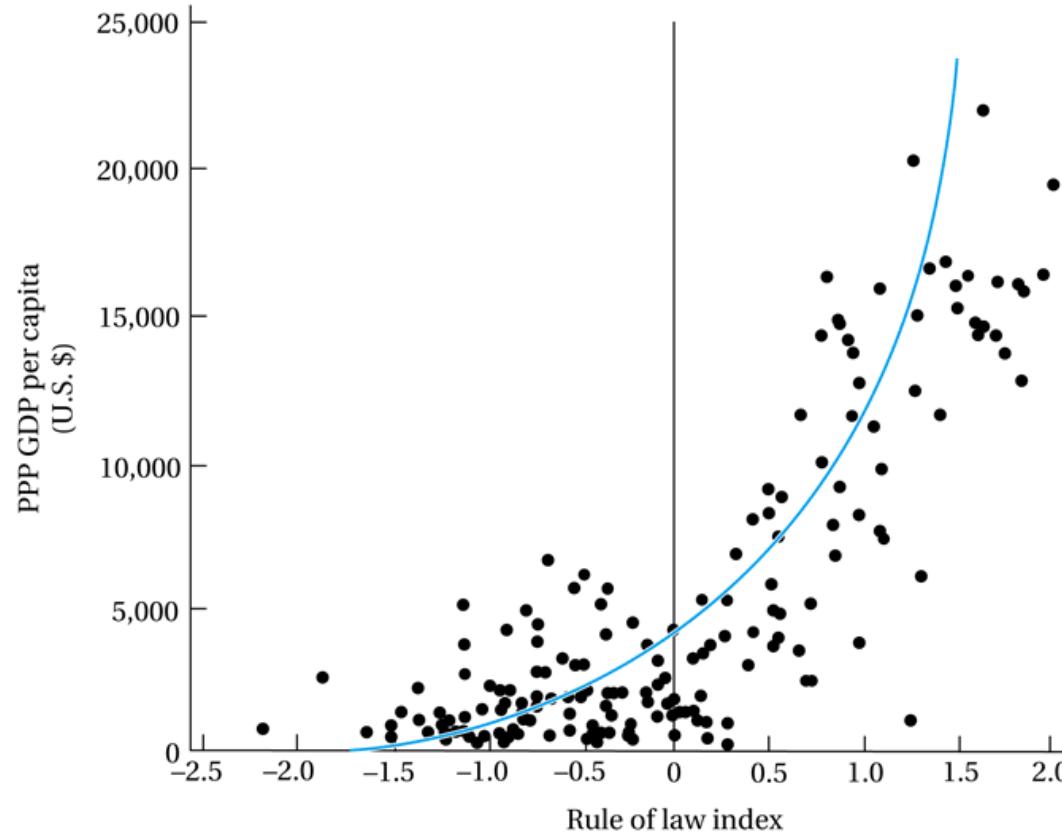
- Tackling the problem of corruption
  - Abuse of public trust for private gain
- Good governance enhances capability to function
- Effects of corruption fall disproportionately on the poor
- Good governance is broader than simply an absence of corruption

## Figure 11.3 Corruption as a Regressive Tax: The Case of Ecuador



Source: *World Development Report, 2000–2001: Attacking Poverty*, by World Bank, p. 102, fig. 6.2. Copyright © 2000 by World Bank. Reproduced with permission.

## Figure 11.4 The Association between Rule of Law and Per Capita Income



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1. Which one does not belong to three basic types of planning models?

- (a) aggregate growth models.
- (b) input-output analysis.
- (c) project appraisal.
- (d) the Washington Consensus.

2. The price reflecting the true social opportunity costs of a resource is known as

- (a) a shadow price.
- (b) an equilibrium price.
- (c) a world price.
- (d) a price index.