

Economic Development

12th Edition

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Chapter 11

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



11.1 A Question of Balance

- Roles and Limitations of State, Market, and the Citizen Sector/NGOs in Achieving Economic Development and Poverty Reduction



11.2 Development Planning: Concepts and Rationale

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



11.2 Development Planning: Concepts and Rationale (cont'd)

- The nature of development planning resource mobilization for public investment
 - Economic policy to control private economic activity according to social objectives formulated by government
- 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

} China



11.2 Development Planning: Concepts and Rationale (cont'd)

- The Rationale for Development Planning
 - Market failure
 - Resource mobilization and allocation
 - Attitudinal or psychological 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) *present in*
- Capital markets are particularly prone to failure *Class.*



Market and Government Failure: Broader Arguments


US: reaction to COVID-19

- Government failure: in many cases, politicians and *is* bureaucrats 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

The road to the hell is built with
good will.



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
 - Sectoral
 - Project
- 



11.3 The Development Planning Process: Some Basic Models (cont'd)

Aggregate Growth Models: 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



11.3 The Development Planning Process: Some Basic Models (Aggregate Growth Models, cont'd)

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

Where

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

s is the savings rate

S is national savings

δ is the depreciation rate

If g is the targeted rate of output growth, then

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



11.3 The Development Planning Process: Some Basic Models (Aggregate Growth Models, cont'd)

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

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

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

Where n is the labor force growth rate and p is the growth rate of labor productivity



11.3 The Development Planning Process: Some Basic Models (Aggregate Growth Models, cont'd)

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

Where W and π are wage and profit incomes

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

Where s_{π} and s_W are the marginal propensities to save from wage income and profit



11.3 The Development Planning Process: Some Basic Models (Aggregate Growth Models, cont'd)

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



11.3 The Development Planning Process: Some Basic Models (cont'd)

- Multisector Models and Sectoral Projections
- Interindustry or input-output models
- Can be extended in 2 ways
 - SAM models where data from national accounts, BOP, and flow-of-funds databases is supplemented with household survey data.
 - CGE models where utility and production functions are estimated and impacts of policies are simulated.



11.3 The Development Planning Process: Some Basic Models (cont'd)

- Project Appraisal and Social Cost-Benefit Analysis
 - Basic concepts and methodology
 - Specify objective function
 - Compute social measures (shadow prices)
 - Establish decision criterion



11.3 The Development Planning Process: Some Basic Models (Project Appraisal and Social Cost-Benefit Analysis, cont'd)

- Computing shadow prices and social discount rates
 - Calculating the social rate of discount or social time preference



11.3 The Development Planning Process: Some Basic Models (Project Appraisal and Social Cost-Benefit Analysis, cont'd)

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



11.3 The Development Planning Process: Some Basic Models (Project Appraisal and Social Cost-Benefit Analysis, cont'd)

- Choosing projects: some decision criteria
 - NPV rule
 - 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

- The 1980s policy shift toward free markets



11.4 Government Failure and Preferences for Markets over Planning (cont'd)

- Problems of Plan Implementation and Plan Failure
- Theory versus practice
- Deficiencies in the plans and their implementation
- Insufficient and or unreliable data
- Unanticipated economic disturbances, external and internal
- Institutional weaknesses
- Lack of political will
- Conflict, post-conflict, and fragile states



11.5 The Market Economy

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



China



11.5 The Market Economy (cont'd)

- 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
- However, it did not always accord with realities in developing countries that were successful (see Box 11.1)

Box 11.1 The Washington Consensus and East Asia


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

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



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

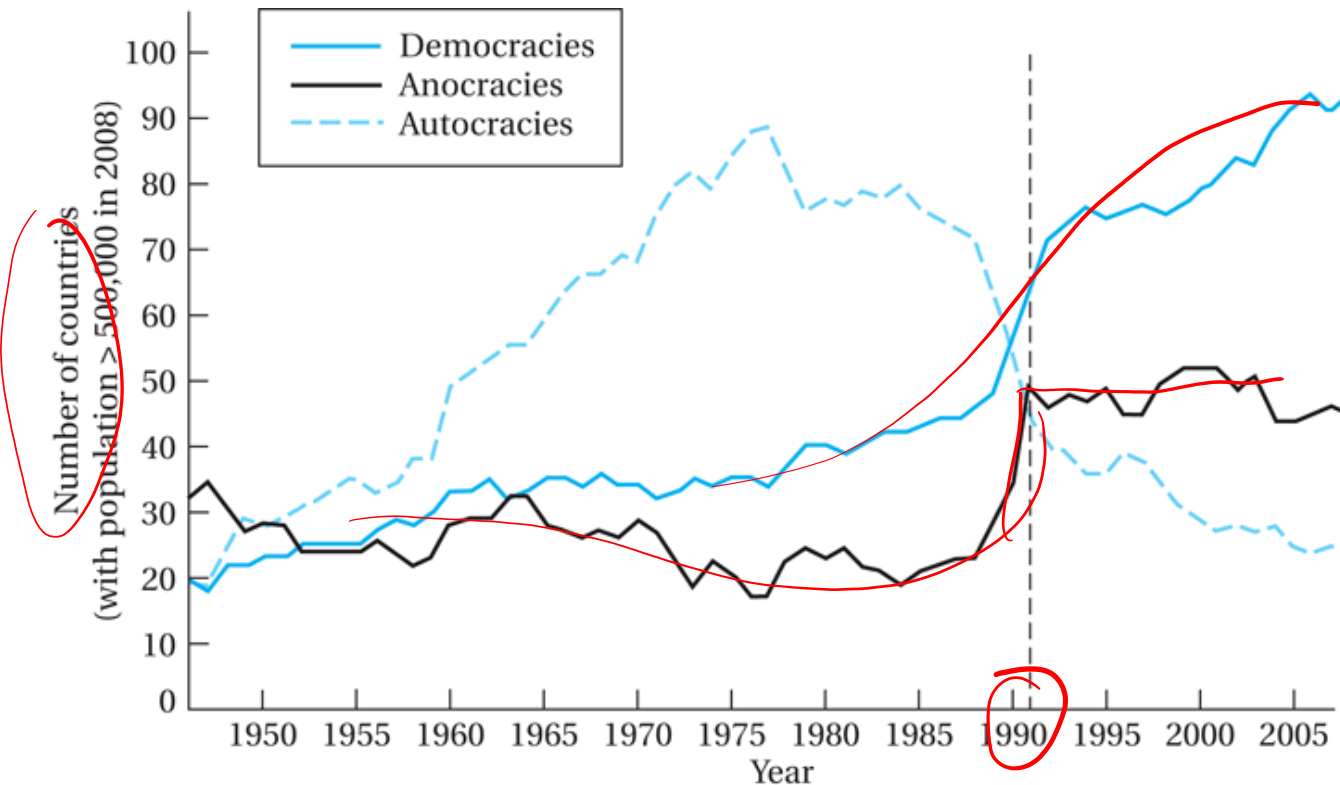
- Toward a new consensus
 - New emphasis on government's responsibility toward poverty alleviation and inclusive growth
 - Provision of fundamental public goods
 - Importance of health and education
 - A recognition that markets can fail
 - Governments can help secure conditions for an effective market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



11.7 Development Political Economy: Theories of Policy Formulation and Reform

- Understanding voting patterns on policy reform
- Institutions and path dependency
- Democracy versus autocracy: which facilitates faster growth?
- Role of NGOs in development and the broader citizen sector

Figure 11.1 Global Trends in Governance, 1946-2008



Source: Monty G. Marshall and Benjamin R. Cole, *Global Report 2009: Conflict, Governance, and State Fragility* (Vienna, Va.: Center for Systemic Peace) 2009, p. 11. Reprinted with permission from the Center for Systemic Peace.

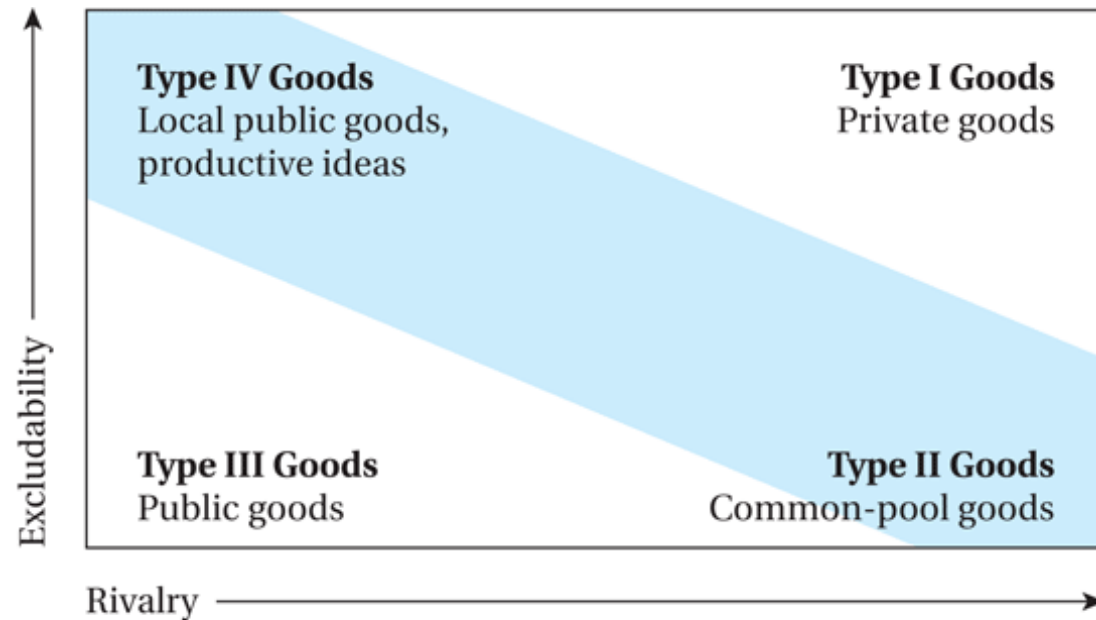
Note: An anocracy is a mixed, or incoherent, authority regime.



11.8 Development Roles of NGOs and the Broader Citizen Sector

- 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 (cont'd)

- 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



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, 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

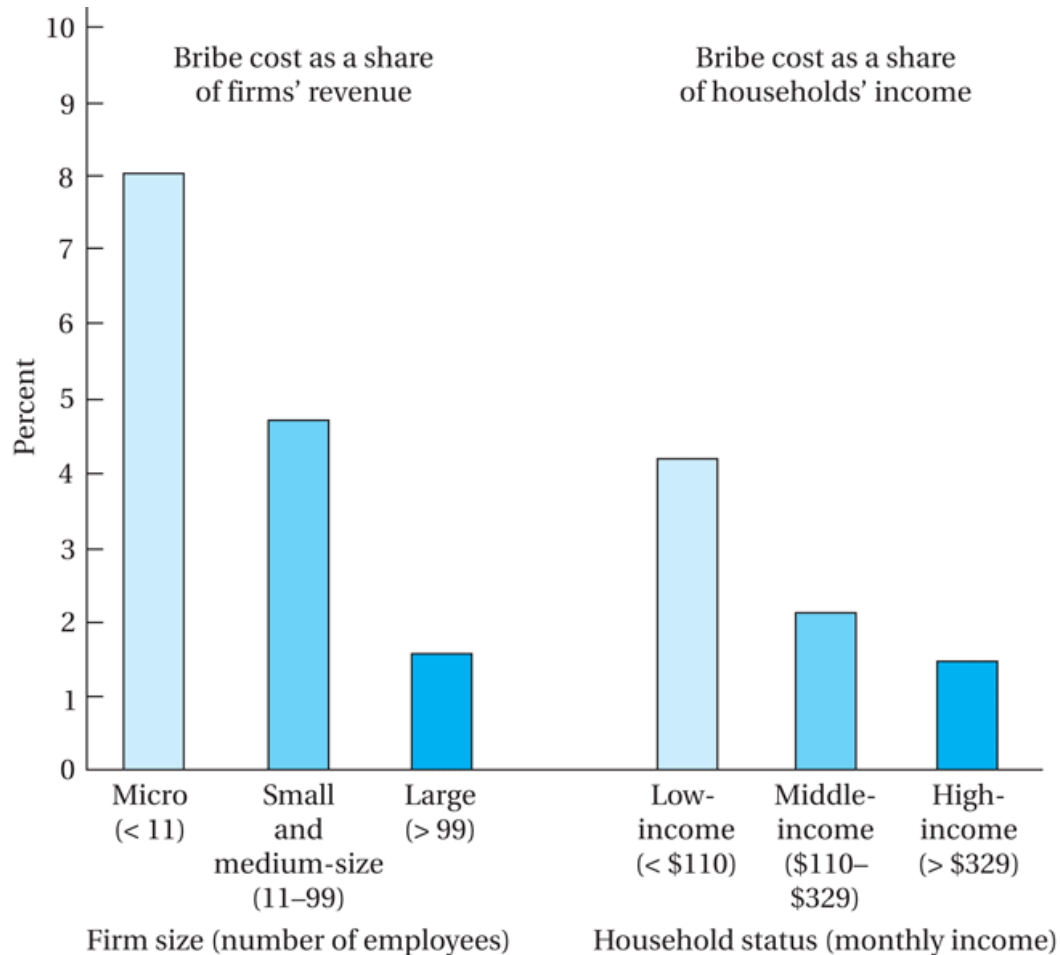
- Tackling the problem of Corruption
- Decentralization
- Development participation- alternate interpretations
 - Genuine participation and role of NGOs



11.9 Trends in Governance and Reform (cont'd)

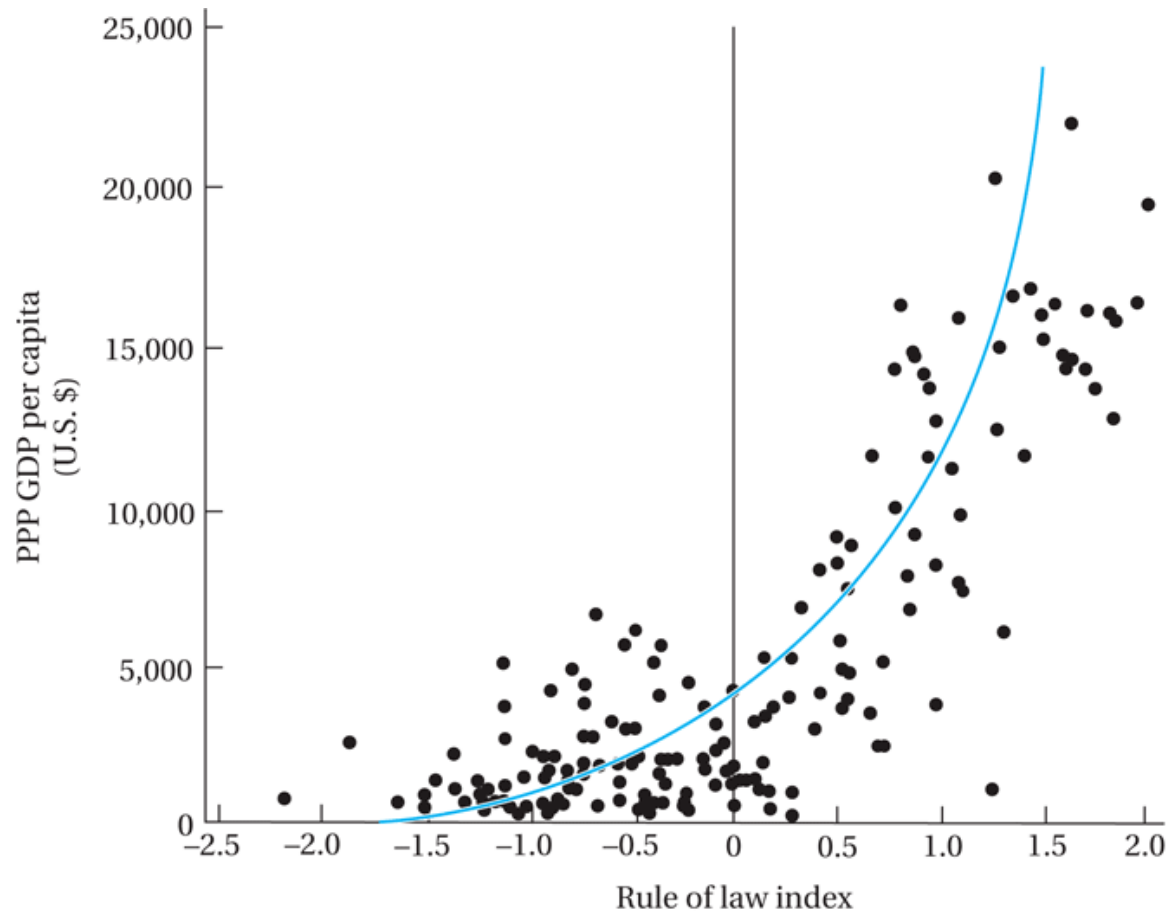
- Tackling the problem of corruption
 - Abuse of public trust for private gain
- Good governance enhances capability to function
- Effects of corruption fall disproportionately on the poor
- Good governance is broader than simply an absence of corruption

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



Source: *World Development Report, 2000–2001: Attacking Poverty*, by World Bank, p. 103, fig. 6.3. Copyright © 2000 by World Bank. Reproduced with permission.



Concepts for Review

- Accounting prices
- Aggregate growth model
- Comprehensive plan
- Corruption
- Cost-benefit analysis
- Economic infrastructure
- Economic plan
- Economic planning
- Government failure
- Input-output model
- Interindustry model
- Internal rate of return
- Market failure
- Market prices
- Net present value



Concepts for Review (cont'd)

- Nongovernmental organization (NGO)
- Partial plan
- Path dependency
- Planning process
- Political will
- Project appraisal
- Rent seeking
- Shadow prices
- Social profit
- Social rate of discount
- Voluntary failure