

Replacing the Washington Consensus on Poverty Reduction: Not From Market Fundamentalism to Institutional Fundamentalism but to MDG-Based Program

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Development economics repeats itself, first as tragedy, second as

farce [format is from the opening sentences of Karl Marx's "The Eighteenth Brumaire of Louis Bonaparte" (1852)]

- First Wave: Part of movement to replace neoclassical economics – **Keynesian macroeconomics for the First World, and Development Economics for the Third World**
- Second Wave: Subsumed both as applications of neoclassical economics – **Monetarist and New Classical counter-revolutions in macro, and Washington Consensus for development economics**

Washington Consensus-Two Generations

- Washington Consensus I (emerged in mid-1960s, comparative studies on trade regimes e.g. Balassa, Krueger, Bhagwati): **Get the prices right**
- Good bye financial repression, hello financial crash; replacing public monopolies with private monopolies; more inequality without efficiency gains
- Washington Consensus II (emerged in mid-1980s, new institutional economics, Douglas North, Dani Rodrik): **Get the institutions right**
- Transparent rule of law; adequate prudential regulations and monitoring; effective competition policy; defining and protecting property rights

1990 Washington Consensus, 1-4

- Fiscal discipline.
- A redirection of public expenditure priorities toward fields offering both high economic reforms and the potential to improve income distribution, such as primary health care, primary education, and infrastructure.
- Tax reform (to lower marginal rates and broaden the tax base)
- Interest rate liberalization.

1990 Washington Consensus, 5-10

- A competitive exchange rate.
- Trade liberalization.
- Liberalization of inflows of direct foreign investment
- Privatization.
- Deregulation (to abolish barriers to entry and exit)
- Secure property rights.

Post-1990 developments, "institutions trump all other factors" (Rodrik) is present mantra

African governance unusually bad?

- Good governance requires resources, e.g. computerisation of records, technical training, adequate compensation for civil service
- In competitiveness scoring, Singapore ranks high in governance index. Singapore has highest-paid cabinet in the world
- After controlling for income level, is African governance unusually bad? NO

Table 1. Governance Quality and Income^a

Dependent variable	(I)	(II)	(III)	(IV)
	Corruption Perceptions Index, 2003 ^b	Index of Economic Freedom, 2001 ^c	Average Kaufmann, Kraay, Zoido-Lobaton indicators, 2000 ^d	Average ICRG indicators, 1982-1997 ^e
<i>Independent variable</i>				
log(GDP pc PPP 2001)	1.05 (5.31)	-0.48 (-4.75)	0.4 (5.20)	0.45 (4.00)
Dummy variable for tropical sub-Saharan Africa ^f	0.58 (1.57)	-0.27 (-1.58)	-0.05 (-0.33)	0.15 (0.71)
R-squared	0.4	0.27	0.42	0.29
N	67	82	92	73

Sources: Authors' regressions using data from Transparency International (2004); Miles Feulner, and O'Grady (2004); Kaufmann, Kraay, and Zoido-Lobaton (2002); PRS Group (2004); World Bank (2003).

a. The sample consists of ninety-two countries worldwide, excluding high-income countries and former republics of the Soviet Union. All regressions are ordinary least squares and include a constant term (not reported). Numbers in parentheses are t statistics; coefficients within statistical significance at the 5 percent level are in bold.

b. From Transparency International, this index relates to the degree of corruption in the country as perceived by business people, academics, and risk analysts and ranges between 10 (highly clean) and 0 (highly corrupt).

c. The index is published by the Heritage Foundation and the Wall Street Journal and ranges from 1 to 5, where 5 indicates the greatest government interference in the economy and the least economic freedom.

d. Average of six World Bank governance indicators measured in units ranging from about -2.5 to 2.5, with higher values corresponding to better governance outcomes.

e. Average of six governance indicators from the International Country Risk Guide, with values ranging from 1 to 6, with higher values reflecting better governance.

f. Refers to sample of 33 countries defined in Sachs et al. (2004)

Institution trumps everything?

Assuming that four factors are relevant to growth, which is more plausible?

1. A nonlinear specification:

$$y = \left[\sum_{i=1}^4 a_i x_i \right] + \left[x_4 \sum_{i=1}^3 b_i x_i \right] + c [x_1 x_2 x_3 x_4] + \varepsilon$$

where y = trend growth rate of output; x_i = factor i , a_i , b_i and c are technical coefficients, and

ε is a measure of our ignorance (assuming that there are only 4 relevant factors)

2. A prerequisite specification:

$$y = x_{institution} \left[\sum_{i=1}^n b_i x_i \right] + \varepsilon$$

Table 2: Regressions Explaining Economic Growth in Tropical sub-Saharan Africa with Governance Indicators^a

Independent variables	(I)	(II)	(III)	(IV)	(V)
Tropical Sub-Saharan Africa dummy ^b	-3.28 (-4.56)	-3.06 (-6.50)	-2.68 (-6.11)	-3.43 (-7.05)	-3.40 (-6.46)
Corruption Perception Index 2003, Transparency International ^c	0.83 (5.23)				
2001 Index of Economic Freedom ^d		-0.96 (-2.75)			
2000 Average Kaufman, Kraay, Zoido-Lobaton indicators ^e			1.89 (5.91)		
1982-1997 Average ICRG Indicators ^f				1.56 (5.29)	
1982 Average ICRG Indicators ^g					0.68 (3.78)
log(GDP pc PPP in 1980)	-2.07 (-7.02)	-1.65 (-6.06)	-1.75 (-7.07)	-2.00 (-7.01)	-1.82 (-5.84)
R-squared	0.58	0.46	0.59	0.59	0.54
N	60	71	78	65	52

Sources: This table from Sachs et al. (2004). Regressions use data from Transparency International (2004); Miles Feulner, and O'Grady (2004); Kaufmann, Kraay, and Zoido-Lobaton (2002); PRS Group (2004); World Bank (2003).

a. The dependent variable is average annual growth of GDP per capita, 1980-2000. The sample consists of ninety-two countries worldwide, excluding high-income countries and former republics of the Soviet Union. All regressions are ordinary least squares and include a constant term (not reported). Numbers in parentheses are t statistics; all coefficients reach statistical significance at the 1 percent level.

b. Refers to sample of 33 countries defined in Sachs et al. (2004)

c. From Transparency International, this index relates to the degree of corruption in the country as perceived by business people, academics, and risk analysts and ranges between 10 (highly clean) and 0 (highly corrupt).

d. The index is published by the Heritage Foundation and the Wall Street Journal and ranges from 1 to 5, where 5 indicates the greatest government interference in the economy and the least economic freedom.

e. Average of six World Bank governance indicators measured in units ranging from about -2.5 to 2.5, with higher values corresponding to better governance outcomes.

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Institutional fundamentalism is unjustified because one-variable primacy is non-historical

- Previous regressions show statistical significance of tropical African dummy despite presence of various proxies of institutions
- Hall-Jones fundamentalist interpretation also rejected
- China and Vietnam grew despite primitive institutions

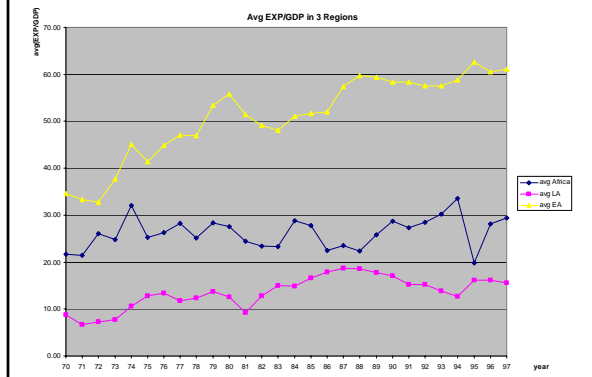
Two blind spots of Washington Consensus

- No acknowledgment of scientific innovations as engine of growth
 - trade-led growth or science-led growth
 - Africa more trade-oriented than LA
 - export composition of EA increasingly high-tech
- No acknowledgement of poverty traps, i.e. limits to self-help

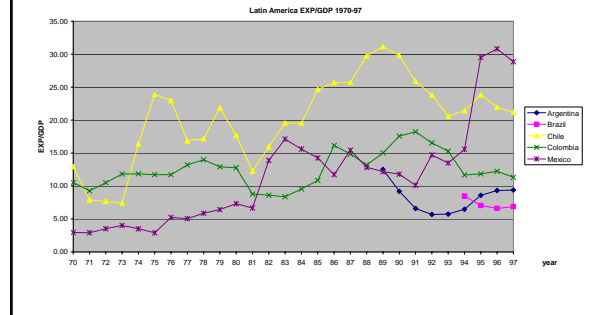
1st blind spot: See Forest but not Trees

- **The Forest:** East Asia is more trade-oriented than Latin America
- **Trees 1:** For countries where the share of manufactured exports is stable, the high value component rises in East Asia but stable in Latin America
- **Trees 2:** For countries where manufactured export share is rising, the rise in East Asia is due mainly to the rise in the high value component. Only Mexico displays this trait.
- Active upgrading of manufacturing sector in East Asia is due to an effective technology policy. **Indigenous innovation & FDI**

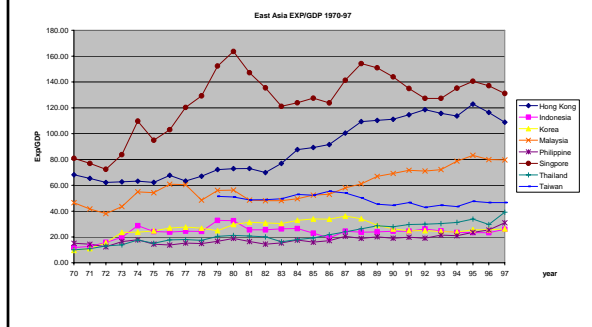
Seeing the Forest: Overall Trade Orientation



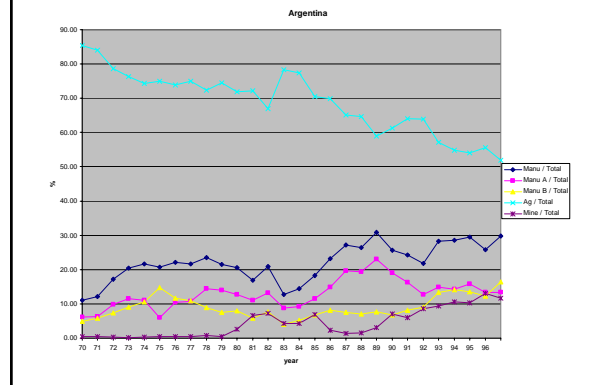
Export Orientation in Latin America



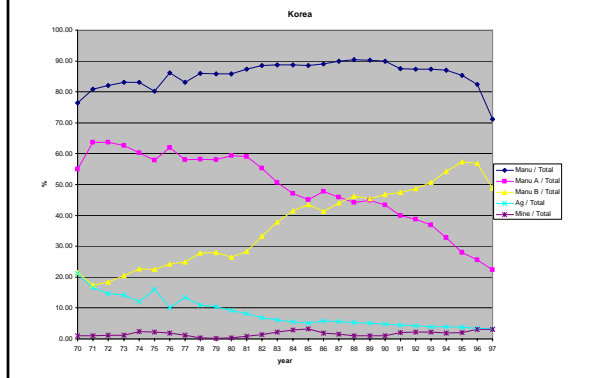
Export Orientation in East Asia



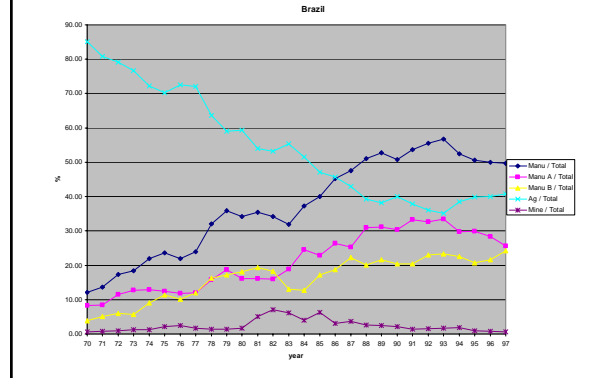
Export Composition in Argentina – Steady Manufactured Share

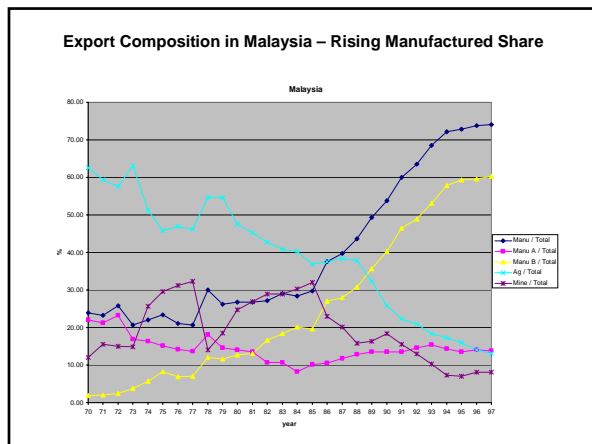


Export Composition in S. Korea – Steady Manufactured Share



Export Composition in Brazil – Rising Manufactured Share





Comparing East Asia and Latin America: Differences in Income and Technology Levels: Technological Gap is Wider than Income Gap

	GDP per capita in 2000 (PPP US\$)	Ranking of Technology Level (out of 75)		GDP per capita in 2000 (PPP US\$)	Ranking of Technology Level (out of 75)
East Asia			Latin America		
<i>1. The Four Dragons</i>					
Hong Kong	25,153	33	Argentina	12,311	48
Singapore	23,356	18	Chile	9,417	42
Korea	17,380	9	Mexico	9,023	36
Taiwan	17,223	4	Brazil	7,625	49
			Colombia	6,248	56
<i>2. The ASEAN-4</i>					
Malaysia	9,068	22			
Thailand	6,402	39			
Philippines	3,971	40			
Indonesia	3,043	61			
Average					
East Asia	13,200	28	Latin America	8925	46
4 Dragons	20,778	16			
ASEAN-4	5,621	41			
Latin America Level as % of East Asian Level					
				68	62
Argentina-Brazil-Mexico-Chile Level as % of Malaysia-Thailand-Philippines Level					
				148	76

Ranking of Technology Level is from GCR 2001-2002
 PPP GDP data from HDR 2002, except that for Taiwan which is from GCR 2001-2002

Fixing 1st blind spot: Science infrastructure not just market infrastructure

- University-state-business coalition
- Different funding mechanisms for basic research, and for applied research: public funding and private funding respectively (e.g. NSF and venture capital)
- New industrial policy: more human capital, less physical capital. Target people not sectors.

2nd blind spot: Self help

- Natural mechanism? In US development, labor flowed from poor to rich areas, and capital flowed from rich to poor
- Capital that flow was public capital for infrastructure: interstate, rural electrification, land grant universities [manpower training and focus on ecology-specific problems]
- Rich provinces subsidizing backward provinces (US previously, China presently).
- A landlocked country equally poor throughout

What is to be done? MDG Strategy (1)

- Rural development: science and infrastructure to raise farm productivity
- Urban development: successful urban development and viable export industries are contingent on improving access to rich countries's markets. EPZs?
- Health: reduce depreciation rate on human capital e.g. childhood diseases on future sick days and IQ
- Education: mobilises each individual to be a problem-solver (larger a country, the larger the synergy effects)

What is to be done? MDG Strategy (2)

- Human resources: ability to deliver MDG targets, community-based training to scale up workers in health, education, and extension services
- Gender equality: thinking with half a brain? Equal, education, health and work rights
- Science, technology and innovation: difference between poor and rich
- Regional integration priorities: R&D center for each ecology zone; economies of scale in infrastructure networks; larger market attracts FDI
- Public sector management priorities: governance no worse, but absolute level is dismal

Implementing the MDG Strategy

- Traditional approach: what can you afford to do to pull yourself out of poverty?
- “Needs Assessment” approach: specify outcomes needed to escape poverty trap, calculate costs, mobilise financing from internal and external sources
- Ghana-Tanzania-Uganda case: \$110 per capita annually
- Required ODA as large as 20-30 pct of GDP in some cases (through 2015). Too big?
- 0.7 pct of G7 GDP will do it. How small!

The International Environment as Constraint on Development Strategy

- Ragnar Nurkse (1967) rejected export-led industrialisation because of anticipated resistance by rich countries to structural adjustment
- Until 1992, imperative to fight communism – Asian four dragons as political allies
- Emergence of large players (Brazil, China, India, and former Soviet bloc) unprecedented strains on structural adjustment
- Continuation of open multilateral trading system? Fortress Europe? Future of FTAA?