# Politics and Policy Making in Developing Countries

## Perspectives on the New Political Economy

Edited by
Gerald M. Meier

International Center for Economic Growth

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# Preface

In recent decades economists have learned a great deal about how to stimulate growth and alleviate poverty in developing countries. Yet much of their advice to developing-country policy makers is deemed politically infeasible and goes unheeded. If the worldwide development effort is to succeed, one of the most crucial tasks is to learn how political factors affect economic policy making. This knowledge will permit successful implementation of effective economic policy in the political arena.

In July 1989 the International Center for Economic Growth and the Banco de la República de Colombia sponsored a conference, directed by Gerald M. Meier, on politics and development policy making. Economists, political scientists, and policy makers from many countries gathered in Paipa, Colombia, to consider whether the new political economy, a framework created largely to analyze conditions in the democratic, industrialized countries, can offer insights into economic policy making in developing countries. The participants looked at how elements of the framework such as interest groups, rent-seeking behavior, and the "predatory state" manifest themselves in developing countries and how they influence policy related to trade, land reform, poverty alleviation, privatization, and inflation and stabilization. *Politics and Policy Making in Developing Countries: Perspectives on the New Political Economy* presents the arguments and discussions from that conference.

A fuller understanding of the interaction between politics and economics is essential if politics is to be a tool for sound development policy making rather than a hindrance. And without constructive use of political processes, there is little chance for successful economic reform. By advancing what economists know about policy making in developing countries, this volume increases the potential for positive policy change.

Many individuals and organizations helped make this project possible. In particular, we would like to thank the Banco de la República de Colombia, the World Bank, and the International Development Research Centre (IDRC) of Canada for their financial support. Our gratitude also goes to Francisco Ortega, general manager of the Banco de la República, and his staff, without whose support the conference could not have taken place.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
May 1991

# Editor's Preface

This book is an outgrowth of a conference that explored how various public policies have advanced or impeded economic development over the past four decades. The conference had two unique features. It was unusual in bringing together not only development economists but also political scientists and policy makers from developing countries and international organizations. And it focused intensively on the strengths and limitations of the "new political economy" in contributing to an understanding of the political determinants of economic policy making in less-developed countries. From the perspective of the new political economy, the participants looked at past experience to see how future policy reform can be undertaken.

The conference was held in Paipa, Colombia, July 12–15, 1989. It was sponsored by the International Center for Economic Growth and the Banco de la República de Colombia. Grateful acknowledgment is made for the support of these organizations and for the funding from other contributors acknowledged in the Preface.

Appreciation is also extended to the participants who accepted the invitation to yet another conference, and especially to the participants who undertook the difficult task of writing the papers and offering the comments now included in this volume.

Thanks are also due to Frieda Martin, Julie Hirshen, and Heidi Fritschel of the International Center for Economic Growth and to Pat Sharp of Stanford University for their logistical or editorial help.

Gerald M. Meier

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# PART I

# INTRODUCING THE NEW POLITICAL ECONOMY

GERALD M. MEIER CHAPTER 1

# Policy Lessons and Policy Formation

Despite all the attention given to problems of economic development, we still have much to learn about why some countries develop faster than others. The development record since 1950 is varied. Some countries—such as the East Asian newly industrializing countries (NICs)—have been success stories, achieving rapid growth in per capita income and alleviation of poverty. In contrast, others have developed slowly or are in decline. An economic policy that has been successful in one country has failed in another. One type of policy has been effective in a country while another type of policy in the same country has not. How are we now to account for these differences in policy performance? How can policy choices and outcomes be explained?

These contrasting policy performances have led economists to draw a number of policy lessons from the post-1950 development experience. Arnold Harberger, for instance, has compiled thirteen such lessons that are the shared conclusions of most professional practitioners and students of economic policy (1984: 428–35). These lessons focus on controlling budget deficits and monetary emission; taking advantage of international trade; valuing neutrality in tax and tariff policy; avoiding excessive income tax rates and excessive tax incentives; steering clear of quotas, licenses, and wage and price controls; and stressing efficiency and financial profitability in public enterprises.

Similarly, Helen Hughes concludes that "many aspects of policy effectiveness remain unsolved, but enough is known to accelerate growth in slowly growing countries. There is now no excuse for the governments of developing countries that do not approach the high, long-run GNP growth of the East Asian countries" (Ranis and Schultz 1988: 142).

Against the background of development policy experience, development economists, political scientists, and policy makers are seeking insights that might help narrow the gap between good economic analysis and good policy making. To do this, they are giving increasing attention to the new political economy as a mode of identifying and interpreting the political determinants of development policy. This book explores the uses and limitations of the new political economy in the belief that attention to formal political economy issues in policy formulation in developing countries is likely to heighten our understanding of development issues and contribute to necessary policy reform.

At the end of World War II, development problems were thrust upon economists. Political independence could be legislated, but economic development could not be established by fiat. How then was development to be achieved? Awakening with the emergence of the new nations, the subject matter of development economics became at once both analytical and policy oriented. Governments needed to make policy choices, and the instrumental character of the state became important. The state was active, and policy advice was sought and given. Much of this advice was based on the welfare economics of the mid-1950s and emphasized the correction of market failure. Government interventions, however, often resulted in policy-induced distortions. Nonmarket or government failure became prevalent. As the shortcomings of the initial policies became apparent, there was the plea to "get prices right" (Timmer 1973). And with the neoclassical resurgence came the more general exhortation to get policies right (Little 1982).

If there is one thing developing countries have not lacked, it is economic advice. Frequently, however, this advice has been ignored. Economists have urged export promotion, but countries continue to follow import-substitution policies. Economists have urged rural development and the removal of urban bias, but governments still emphasize industrialization and neglect agriculture. Economists argue for stabilization, but inflation still prevails.

Why are the development economists not listened to? Why are Harberger's policy lessons not heeded? Part of the answer may be the ineffectiveness of the economist as communicator to the policy maker. Even assuming that economists know what policies are best and that they are united in one voice, they may be ineffective as advisers. The problem is not lack of understanding by the policy maker. Rather the burden lies on the economist to be understandable and persuasive in giving advice. Often advice is too subtle or too complicated to be persuasive. Furthermore, policy prescriptions presented to the policy maker frequently defy any feasible application. Where is there any government that can compute and administer the lump-sum and nondistortionary taxes and subsidies of welfare economics? For most developing countries, even the machinery for direct income taxes is rudimentary. Whereas the economist too often deals with the "first-best" optimal policy, the government must live with the "second-best" or "third-best" in any hierarchy of policy choices.

Moreover, the political calendar has a short time horizon whereas the economist considers longer-term tendencies. But as Lord Keynes observed, "The long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again" (Keynes 1923).

To explain nonmarket failure by the ineffectiveness of the economist as adviser is, however, too ad hoc and simplistic. A deeper explanation lies in the interaction of economics and politics. Such an explanation may be sought in the new political economy. This is to return to the grandest theme in economics—the role of the state and markets. But we now do so in a more rigorous and systematic fashion than that of the old political economy as represented by Adam Smith, Karl Marx, and John Stuart Mill or by contemporary political scientists who do not use the techniques of economic analysis.

## Features of the New Political Economy

By the new political economy (NPE) is meant a neoclassical economic theory of politics. The analytical concepts and principles—as applied to political markets and political phenomena—are analogous to those of neoclassical economic analysis. The unit of analysis is the individual, group, or enterprise. In chapter 5, T. N. Srinivasan defines NPE by "the axiom that agents behave rationally; that is, they have a consistent set of preferences over the outcomes of their actions, and they choose an action whose outcome is preferable to the outcome of other actions they find also feasible, given the constraints within which they act. . . . Agents are assumed to behave rationally, whether they are consumers using available information to form expectations about the future, bureaucrats fighting for turf or distributing publicly created rents, or lobbyists and voters."

The concept of self-interest or self-goal choice is relevant for the NPE, and hence the techniques of maximization, minimization, and optimization apply. Marginal analysis and equilibrium outcomes can be applied to political markets and political objective functions.

Unlike much normative economic analysis, however, the NPE does not assume that the government is composed of Platonic guardians and that the state acts benevolently in seeking the public interest. Economists may refer to a state devoted to the public interest, a social welfare function, Pareto efficiency, and first-best policies. In contrast, the rational choice political economists now focus on other types of states—the Leviathan state, bureaucratic state, or factional state. The Leviathan or bureaucratic state is often a predatory state,[1] preying on its citizens for the economic benefit of an autocracy, policy elite, or bureaucracy. The factional state responds to the interests of pressure groups. It is often a transfer state, redistributing income or wealth from one faction to another. In both the Leviathan state and the factional state, an underdeveloped economy has commonly given rise to an overextended state. For those who apply the new political economy, this overextended state is, as Merilee Grindle observes in chapter 3, a negative state.

The NPE was first related to political processes in the more developed countries, especially those with liberal democratic political institutions.[2] In such countries, the techniques of neoclassical economics have been applied to an economic theory of legislation, reciprocal (pork-barrel) patronage, log rolling, lobbying, and voting by the electorate. Especially prominent has been the use of rent seeking as the basis of modeling political behavior to explain foreign trade intervention and domestic economic regulation. Early contributions were by Downs (1957), Riker (1962), Buchanan and Tullock (1962), Niskanen (1971), and Stigler (1971).

Thus in one type of model—that of endogenous tariff theory—trade restrictions balance the power of narrow interests (lobbies) against that of broad interests (voters). The trade policies are equilibrating variables that clear political (redistributive) markets; they are analogous to prices in product markets that balance the quantity demanded against the quantity supplied. The policy maker is like an auctioneer in a product market, and the demand for protection gives rise to the supply of protection (Magee 1984).

In the mid-1970s, the new political economy began to be applied to political phenomena in the less-developed countries (LDCs). Initial applications were based on rent seeking; Krueger (1974), for example, showed the cost of rent seeking caused by quantitative trade restrictions. Bhagwati (1982) offered a more general analysis of tariff seeking, revenue seeking, and other restriction-seeking activities. The early rent-seeking studies, however, were without political content: the quantitative restriction or tariff was simply imposed exogenously.