I. Introduction

A. What Are Government Policies?
   \textbf{Def}: Public actions (\textit{tools}) designed to change private behavior by affecting the level of \textit{incentives} \& the \textit{distribution} of benefits (e.g., taxes, rules/regulations, subsidies)

   \textbf{Types of policies}
   - Domestic \textit{vs.} international, but are linked
   - Sectoral (e.g., agriculture, mfg.) \textit{vs.} macro (economy-wide) policies

B. What Are Institutions?
   \textbf{Def}: Sets of ordered relationships among people that define their rights, privileges \& responsibilities
   - Informal--based on traditions (e.g., marriage)
   - Formal/laws—SEC, Constitution, WTO
   - Considered \textit{critical} to "successful" development!
C. Why Do Government Policies & Institutions Matter?
Public policies set the rules which determine:

1. Who participates in making:
   - Policies (i.e., who sets interest rates, food prices)
   - Rules for making rules (i.e., who can vote, run for office)

2. Who pays the costs and how much?
   - Examples—taxes, fees, licenses, tariffs

3. Who qualifies for benefits and how much? (Cartoon)
   - Examples: price (crop) support, export subsidies (US, rice), protective import tariff rate (US, sugar beets), China—who can own land

D. All Govt. Policies Redistribute Costs/Benefits between, for example:
   - Regions—dams/roads in one region vs another region
   - Income groups—school lunches for the poor vs tax cuts for the rich
   - Gender—research on men’s vs. women’s crops
   - Urban/rural areas—city hospitals vs. rural health clinics
   - Industries vs. consumers—import tariffs on cars, sugar, clothing

II. What Economic Policies Affect Development & Equity?
A. Investments in Key Public Goods that Increase Productivity

Def: Public goods—goods/services the private sector often won’t provide, especially in poor countries, since poor can’t pay for them

Note: Key justification for public goods—national benefits > private benefits

Examples
   - Education—university, high school, adult literacy to increase skills
   - Infrastructure (China, Brazil)—ports/roads to reduce transport costs
   - Health/sanitation—clinics, clean drinking water to improve health
   - Agricultural research/extension services—generates new technologies/trains farmers to increase national food supply
   - Credit—increases farmers’ access to farm inputs
B. Macro Policies (affect total economy)

1. Set macro prices (administered vs set by market supply & demand)
   **Examples**
   - Foreign exchange rate—fixed (China) vs. market determined (US)
   - Wages—fixed “minimum wage” vs. market-determined rate
   - Interest rates—fixed vs. market-determined rate

2. Establish regulations/licenses
   **Examples**
   - Who can import/export (anyone or need a government license?)
   - Who can buy scarce foreign exchange (Zimbabwe)?
   - Who can open a business (anyone or only locals/nationals?)

C. Sector Policies (targeted at a specific sector)

**Examples (agricultural sector policies)**
- Guaranteed crop prices—raises farmers’ income
- Input subsidies—makes farming more profitable
- Credit subsidies—encourages farmers to buy inputs
- Land reform—gives the landless access/title to land

III. Economist’s Prescription for Economic Growth

A. Historical Setting
   **Conventional wisdom of the 1950s & 1960s (economist’s advice!)**
   - Path to development is via industrialization
   - Government must play a major role in “guiding” development
   - Government should provide subsidies/protect local agriculture & local “infant” industries to “jump start” economy

So, Many LDCs implemented policies that:
- Gave priority to industrialization (like DCs), neglected agriculture
- Gave priority to improving urban areas, neglected rural areas
- Restricted the private sector—imposed many regulations, created state-owned enterprises, nationalized foreign firms

   **Policy Tools**: overvalue currency, control access to currency, tariffs on imports, set low crop prices, consumer price controls, set low interest rates, set high minimum wages, subsidize food prices

- Despite good intentions, these policies distorted the economy, resulted in unintended consequences  **Why/How?**
B. What were some consequences of these policies?

1. Economic stagnation in some countries (beginning in the 1970s):
   Historical Indicators of stagnation include:
   - Slow GNP growth
   - Declining food production/capita (especially in Africa)
   - Increased government budget deficits/debt
   - Deteriorating public services (e.g., ag. research, sanitation)
   - High foreign debt
   - Foreign exchange shortages (debt repayment high)
   - Rapid inflation (e.g., Mexico = 180% in 1988)

2. But economic stagnation was due to both:

   **External Shocks** (factors beyond a country’s control)
   - Declining terms of trade
   - What do LDCs export? (Figures)
   - (def. ratio of price of exported vs. imported goods)
   - Increased in oil price (1972 to early 1980s) (Fig. 11.2)
   - Increase in DC’s interest rates (late ’70s to early ’80s)
   - Drought in Sub-Saharan Africa

   **Internal Factors** (factors within country’s control)
   - Bad economic policies (as described previously)
   - Political instability/ethnic conflicts
   - Rapid population growth
   - Rapid inflation (due to poor policies & “external shocks”)
   - Excessive government regulation (e.g., Zim: computer, buy forex)
   - Corruption—def. “a token of appreciation paid in advance for a deed yet to be performed!” Cleptocracy?

C.W. Bank’s/IMF’s Solution--Structural Adjustment Policy Reforms (SAPs)

Countries **must** remove policy distortions—IF they are to develop

1. Evolving regional focus of structural adjustment program
   - Africa–late 1980s to present
   - Asia–late-1990s (Asian economic crisis) to present (Indonesia)
   - Latin America–1990s to present
2. **Conditionality**—to qualify for assistance, a LDC **must**:
   - Devalue currency **to** increase exports/decrease imports
   - Eliminate food price controls **to** increase food production
   - Reduce subsidies & cut civil service **to** reduce budget deficit
   - Sell state-owned companies/privatize **to** increase efficiency
   - Remove restriction on private sector **to** encourage foreign investment
   - Encourage exports **to** generate foreign exchange
   - Open country to imports/reduce tariffs **to** stimulate competition

3. **IF** the “prescription” is followed, WB/IMF will provide “**structural adjustment loans**” to ease transition to a strong market economy, resulting in growth & development

D. Structural Adjustment (i.e., shift to a market economy) will be achieved in the “long run” (Keynes: “In LR, we’ll all be dead!”):
   - Reduce inflation
   - Increase exports & foreign exchange earnings
   - Reduce foreign debt
   - Increase foreign investment
   - **AND, thereby**, increasing GDP growth/reduce poverty
     - What’s the evidence? *(economic freedom)*

E. Criticisms: **Leaders** in Many LDCs Are Concerned That:

   1. SAPs (the “prescriptions”) have had **severe immediate impacts**
      - Poor/middle class hurt (SAP poverty):
        - Devaluation increased the prices of imports (F.W.A=100%)
        - Reducing subsidies increased the cost of farm input, food prices (e.g., Malawi => farmers stopped using fertilizer)
        - Reducing govt. spending reduced health/education services
        - Cutbacks on public jobs increased unemployment

   2. SAP **reduced** country’s **development potential**, due to cuts in education, health services, agricultural research, etc.

   3. Private sector is too weak to “respond” by provide lost services
4. The “prescriptions” were too general, need to consider differences in country’s situation, problems (Stiglitz-word processed agreements)

5. The “prescriptions” were designed to save foreign banks, multinational corporations who held LDC’s debt

6. SAP can (and have) lead to political unrest, food riots

F. **Stiglitz’s Unexpected Criticisms** (WB’s Chief Economist, Nobel laureate)

1. World Bank has betrayed its original assumption
   - Original idea--Markets don’t always work, so need to increase spending or reduce taxes to counter drop in demand (Keynes’ solution to 1930s depression)
   - New idea (1980s)--emergence of market fundamentalists, markets always work (ideology trumps economics)

2. The “**Washington Consensus**” dominated World Bank/IMF Policies
   - US promoted free market/conservative principles at the WB/IMF
   - Three-pronged approach--**austerity, privatization & market liberalization** are THE path to development and all else will follow

3. Impacts/Consequences of SAPs (Stiglitz)
   - Some LDC’s who adopt these policies saw their economies contract/decline
   - High interest rates, required to reduce inflation => unemployment
   - WB failed to foresee the Asian economic crisis and forced affected countries to adopt policies that often made the crisis worse

4. Recommendations (Stiglitz)
   - Carry out poverty impact statement to assess the impact all WB policies—must fine tune SAPs to fit each LDC’s unique situation
   - Replace goal of low inflation with goal of full employment
   - Development is about improving peoples’ lives, so that should be the criteria of success (not how fast banks are repaid)
G. The World Bank/IMF Response to its Critics

- Reforms are needed to restructure mismanaged economies: balance governments' budget, reduce inflation, increase productivity, trade & foreign investment.
- If LDCs don't implement SAP reforms, situation will only get worse.
- In the long run, SAP reforms will work (recall Keynes' comment).
- We (WB/IMF) know what's best (If LDCs protest => no loan)

H. Most LDC have

- Implemented SAP programs
- Expanded economic freedom, but economic reforms still needed (e.g., India—"scissors to cut red tape") (Economic Freedom map)
- WB says LDCs have experienced some economic growth as a result of adopting reforms

But many negative impacts:
- Growing rich-poor income distribution gap
- Economic growth has been slower than expected
- Reforms have had little impact on reducing poverty
- Short run social consequences of policies have been severe

So, many governments & people in LDC
- Are increasingly critical of market-oriented reforms, privatization, (especially in Latin America)
- Are electing (democratic) left-leaning/socialist governments (e.g., Brazil, Chile, Ecuador, Venezuela, Bolivia) committed to reducing poverty/inequality, rejecting the Washington Consensus
- Current financial crisis is a further blow to free-market dogma: regulation is bad, free markets will correct themselves
IV. Democratic Reforms Needed for Development

A. Problems in Some LDCs that Suggest a Need for Democratic Reforms

**Key Issues**
- Government is not accountable to the people
- Many—esp. the poor—have no say in government decision making
- Government policies benefit the elite—the poor lack equal access to opportunity
- Democratic institutions are weak—absence of a free press, freedom of assembly, free elections, free labor unions, etc.
- Corruption is rampant—diverts resource from development
  (But lack of "business ethics" in US = a form of corruption)

**Consequences**
- Political instability/conflicts (often financed by commodities?), which leads to economic stagnation (e.g., Congo, Somalia, Zimbabwe)

B. Solution—Implement Reform to Empower Marginalized People/Groups

**Def. Empowerment**—policies designed to more widely distribute political power/benefits

1. Political Democracy
   **Rational**
   - New institutions/rules will empower people
     (e.g., free press, freedom of assembly, free labor unions, strong legislatures, political parties, independent judicial system, open access to information)

   - Democratic reform => economic reforms => will create a more productive economic environment
     (e.g., values of equality, transparency, accountability, clearly defined property & labor rights, free markets, just settlement of contract disputes, fair taxation)
Which will in turn:

- Attract foreign capital (i.e., investors will only risk capital if the legal/legal/political system is stable)
- Lead to partnerships between government & civil society (NGOs) to address development needs
- Attract more foreign aid to fund development projects
- Help to reduce corruption (e.g., free press, regulatory agencies, courts, parliament, strong NGOs/strong civic society)

And thereby accelerate development

Some Recent Successes: Evidence of Growth in Democracies

- Decline in civil conflicts (UN report) due to increased attention paid to peacekeeping, UN assistance to resolve conflicts
  - Sierra Leone/Burundi—peaceful election after years of civil war
  - Reconciliation after conflicts (South Africa, Sierra Leone)
- Decline in inter-state conflicts since the 1990—interlinked economies, system of sanctions, unacceptable to world community
- Worldwide Increase in “freedom” and democracy--62% (2009) of 191 governments are democratically elected vs 40% 15 years ago
- Evidence of maturing democracies—fair/free elections in Ghana, Liberia, Kenya, Mozambique, South Africa, Malawi, Namibia, Indonesia, Mexico
- Recent election in India—Congress Party won over Hindu Party
- Growing influence of civic society groups in combating corruption (e.g., Zambia) & ethnic violence (e.g., Kenya)
- Growing political power among indigenous (e.g., Bolivia, Ecuador)
Some Concerns/Challenges to Democratization

- **Africa**—civil wars continue due to struggles to control resources (diamonds, timber, cocoa), ethnic diversity, collapse of weak states (e.g., Ivory Coast, Somalia, Congo)

- **Middle East**—only 2 of 14 govts. are democratically elected
  - Islam **not** the problem—democratic Indonesia, India, Turkey account for 25-33% of world’s Muslim population

- **Free press** threatened in some countries (8 year decline)
  - (e.g., China, Mexico, Russia, Venezuela, Uganda, Nepal, Ethiopia)
  - Increasing harassment/imprisonment of journalists, govt. censorship of press & internet

- **Anti-democratic backlash** in some Latin American countries
  - Failure of market/democratic reforms to improve people’s lives is undermining faith in democracy

- **Corruption** continues to threatens democracy/development

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2. Grassroots Democracy/Civil Society (NGOs/non-profit groups)

**Def.** Local groups that give people more control over their destinies (e.g., community/church/woman’s groups, labor unions, trade asso.)

- **Strengths of NGOs**
  - Are close to the people—empower the poor/oppressed
  - Promote political change
  - Force leaders to be more accountable
  - Promote key values (e.g., honesty, fairness, transparency)

- **Some Successes**
  - **Local Impacts**
    - Kenya—Green Belt Movement
    - Urban self-help groups, micro finance groups (Grameen bank)

  - **International Impacts**
    - Pressured DC to grant debt relief (Jubilee 2000)
    - Responsible for international treaty banning land mines
    - Have forced private companies to address labor abuses, etc.
    - Have raised public awareness of corruption/created pressure for reforms
C. US’s Strategy for Promoting Democracy

- **Carrot & stick approach**
  - Cut foreign aid to countries that don’t support democratic reforms
  - Increase foreign aid to real democracies

- **Current Administration--Focus on Africa**
  - Obama “tough love—countries must combat corruption
  - Hilary Clinton—countries must give priority to good governance

- **Some recent developments/concerns**
  - 9/11 resulted in greater political support for aid--increasing recognition that poverty contributes to terrorism
  - Critics argue that the US assumes the democracies will flourish, if authoritarian leaders step aside, but **democracy requires** creating the “conditions for social agreement” from the **bottom up**
  - Obama administration placing greater priority to private sector--individuals/NGOs--vs pressuring governments to implement democratic reforms

V. Conclusion

- **Economic challenges** facing LDCs are due to both:
  - **External** (oil crisis, terms of trade, interest rates) and **Internal** factors (government policies, weak institutions, corruption)

- What have been the **impact** of SAPs?
  - Reforms have had **severe negative impacts in some countries**
  - Reforms have **failed to reduce poverty**
  - **Unless** economic reforms improve the lives of the poor, they will undermine the trend towards democratization, **threaten stability**

- Is international pressure justified to encourage LDCs to implement economic & democratic reforms?
  - **Yes,** reforms are necessary
  - **But,** reforms must be **designed** to meet each country’s **specific** needs designed to avoid potentially negative impacts

- Pressure from **civic society** groups is required for **sustainable reforms**

- **Political & economic reforms** are **complementary**—they reinforce each other to promote economic development