Development Economics
Lecture Notes 7

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Political Economy of State

There have been three phases:

1. 1950-1980, State is the prime mover: Planning Mystique
2. 1980-late 1990s, Leave everything to the Markets: Washington Consensus
3. Late 1990s-, Recognize both the Market and the Government Failures: The New Consensus
The Rationale for Development Planning

- Market Failures
- Resource mobilization and allocation
- Attitudinal or Psychological impact
- Foreign Aid
Planning involves three types of modeling processes

1. Aggregate Growth Models
2. Multisector Models and Sectoral Projections: Input-Output Analysis and Social Accounting Matrices (SAMs)
3. Project Appraisal and Social Cost and Benefit Analysis
Social Cost and Benefit Analysis is based on

- Setting Objectives
- Computing Shadow Prices and Social Discount Rates

The last item is important for the fact that market prices would not reflect real costs and benefits in LDCs because of

1. Inflation and currency overvaluation
2. Wage rates, capital costs and unemployment
3. Tariffs, quotas, and import substitution
4. Saving deficiency
5. The social rate of discount
\[ NPV = \sum \frac{B_t - C_t}{(1 + r)^t} \]  

The Net Present Value should be positive.
Government Failure and Reasons for Plan Failure

- Deficiencies in Plans and Their Implementation
- Insufficient and Unreliable Data
- Unanticipated Economic Disturbances: External and Internal
- Institutional Weaknesses
- LACK of POLITICAL WILL
Washington Consensus

1. Fiscal Discipline
2. Redirection of public expenditures toward health, education and infrastructure
3. Tax reform, including the broadening of the tax base and cutting marginal tax rates
4. Unified and competitive exchange rates
5. Secure property rights
6. Deregulation
7. Trade liberalization
8. Privatization
9. Elimination of barriers to Foreign Direct Investment
10. Financial Liberalization
The NEW CONSENSUS

1. Development must be market-based, but there are large market failures that cannot be ignored.
2. Government should not be in the business of direct production.
3. Nevertheless, there is a broad, eclectic role for government in the following areas:
   - Providing a stable macro environment
   - Infrastructure, though in fewer sectors than thought necessary in the past
   - Public health
   - Education and training
- Technology transfer
- Ensuring environmentally sustainable development and ecological protection
- Providing export incentives
- Ensuring 'shared growth' by acting to reduce poverty and income inequality
- Continued if more moderate regulation and support in financial sectors
- Provision of fundamental public goods, such as legal structure, including protection of property rights
Political Economy of Development Policies

- Understanding Voting Patterns on Policy Reform
- Institutions and Path Dependency
- Democracy versus Autocracy
Organizational Comparative Advantage of NGOs

1. Innovation
2. Program Flexibility
3. Specialized Technical knowledge
4. Targeted local public goods
5. Common-property resource management design and implementation
6. Trust and credibility
7. Representation and advocacy
Trends in Governance and Reform

- Tackling the problem of corruption
- Decentralization
- Development participation