


# Making Policy Work for Development

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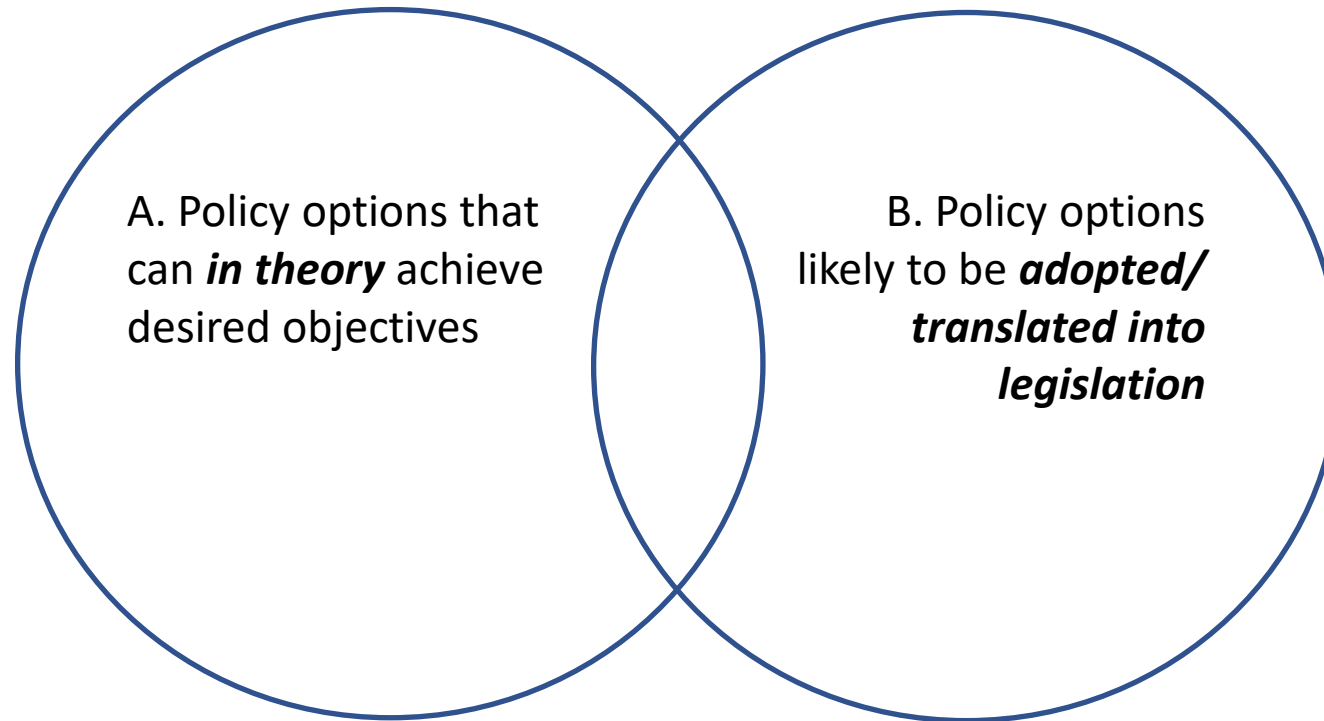
# The Policy Question



A. Policy options that can *in theory* achieve desired objectives

Most textbook policy discussions focus on this: How can policy (RULES) change the incentives (of INDIVIDUALS AND ORGANIZATIONS) to change their behaviour?

# The Policy Question

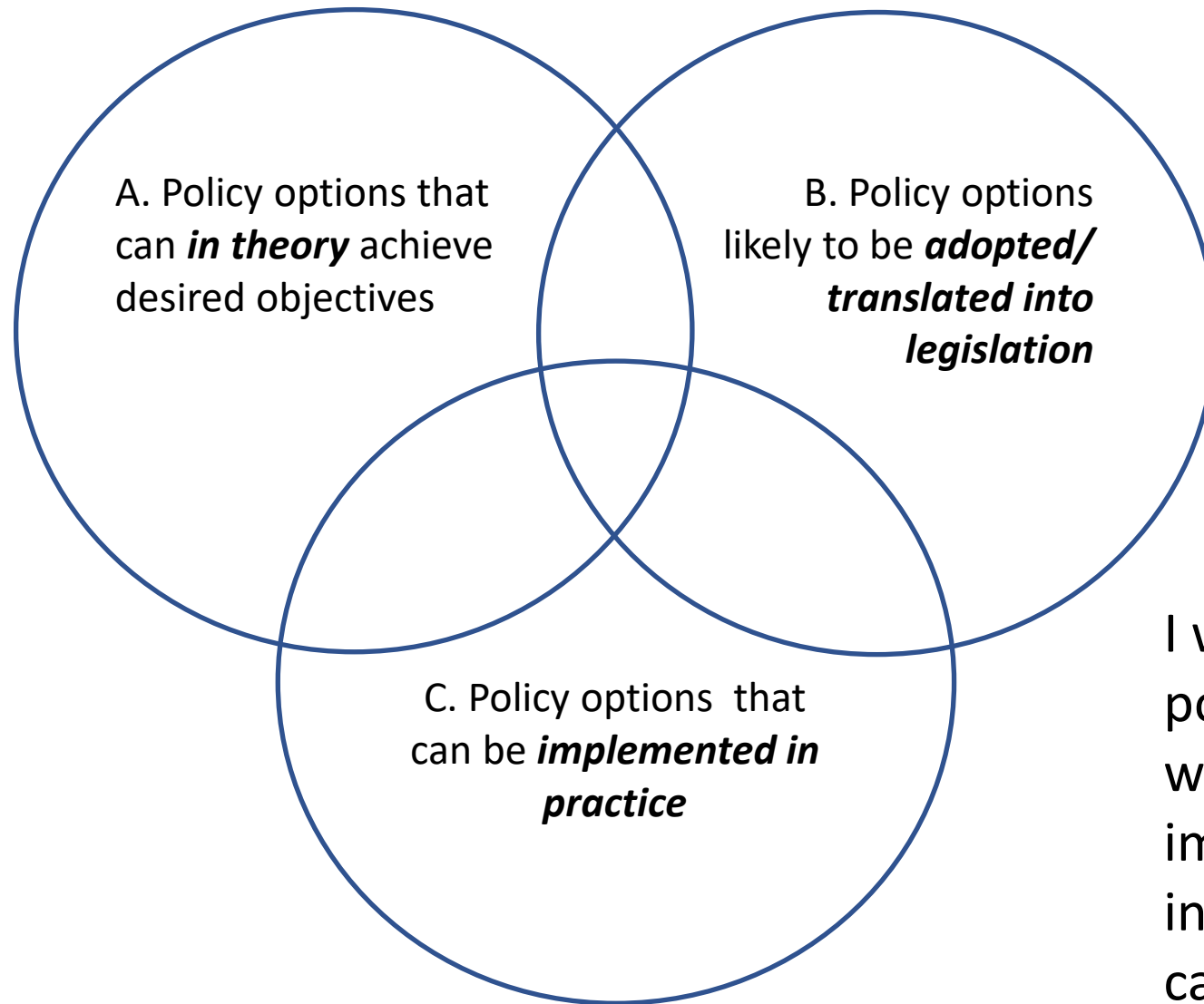


A. Policy options that can *in theory* achieve desired objectives

B. Policy options likely to be *adopted/translated into legislation*

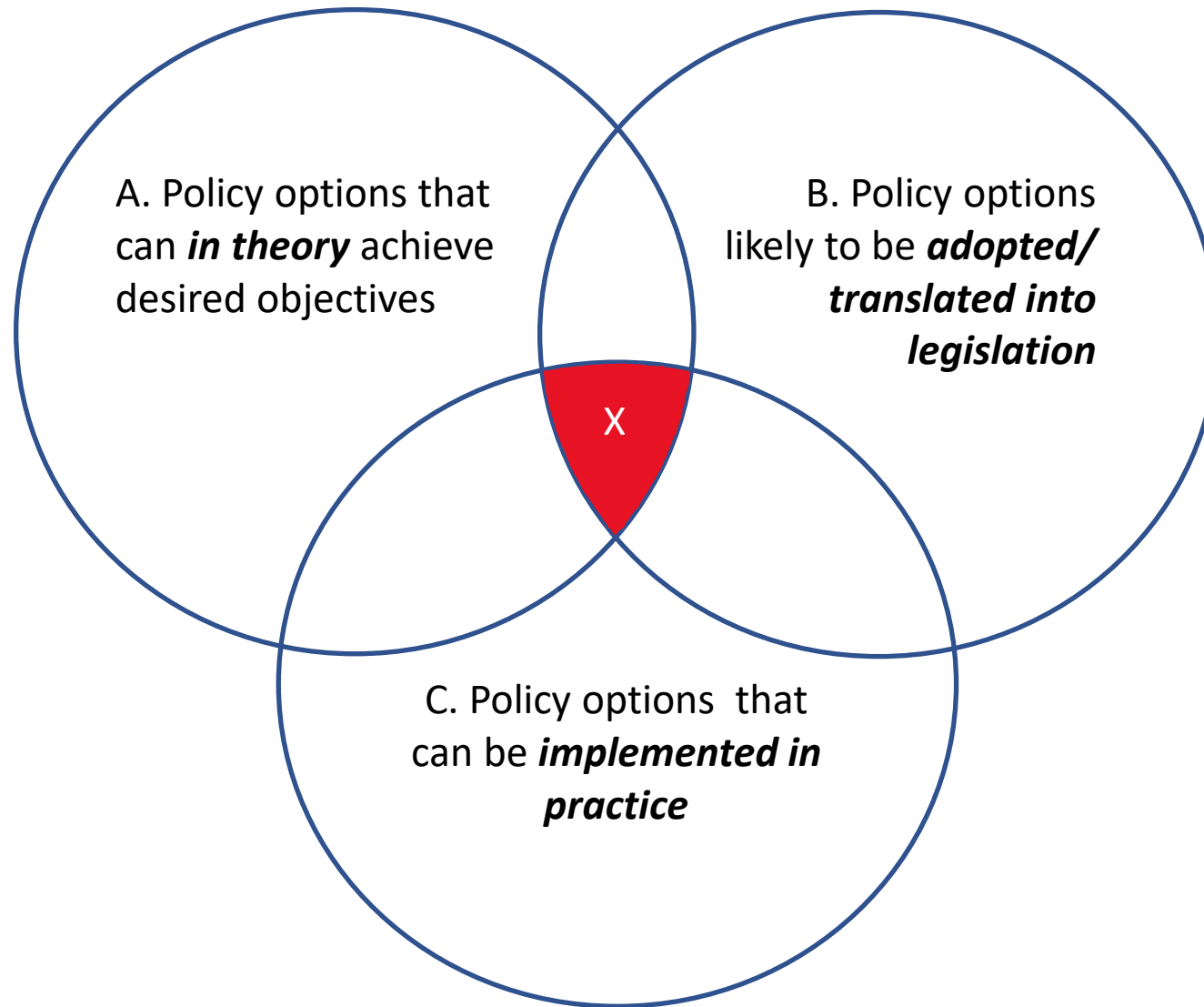
The political economy of policy adoption brings in the conflicts of interests driving policy adoption: class and group interests at the policy-making level

# The Policy Question



I will focus on a separate political economy problem: what constrains policy implementation? This involves the power and capabilities of a different set of actors

# The Policy Question



# Policies, Institutions and Development: The 'Implementation Issue'

Gunnar Myrdal's *Asian Drama* (1968) raised a question that continues to dominate institutional economics: Why is policy implementation much more difficult in some countries?

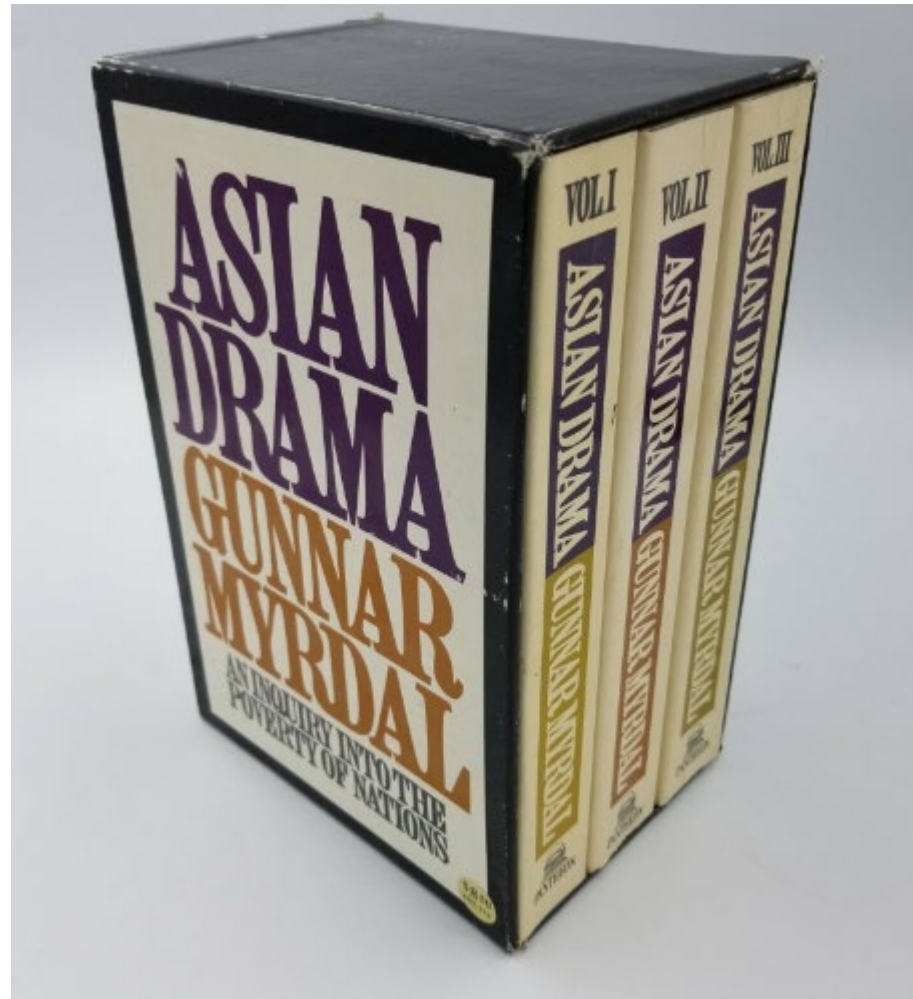
Many key components of later analysis emerged in these volumes:

Corruption

The Soft State

Informal Institutions including Culture

Radical / revolutionary transformation as the only alternative



Subsequent research focused on similar issues:

Rents and Rent seeking

Government failures and Market failures

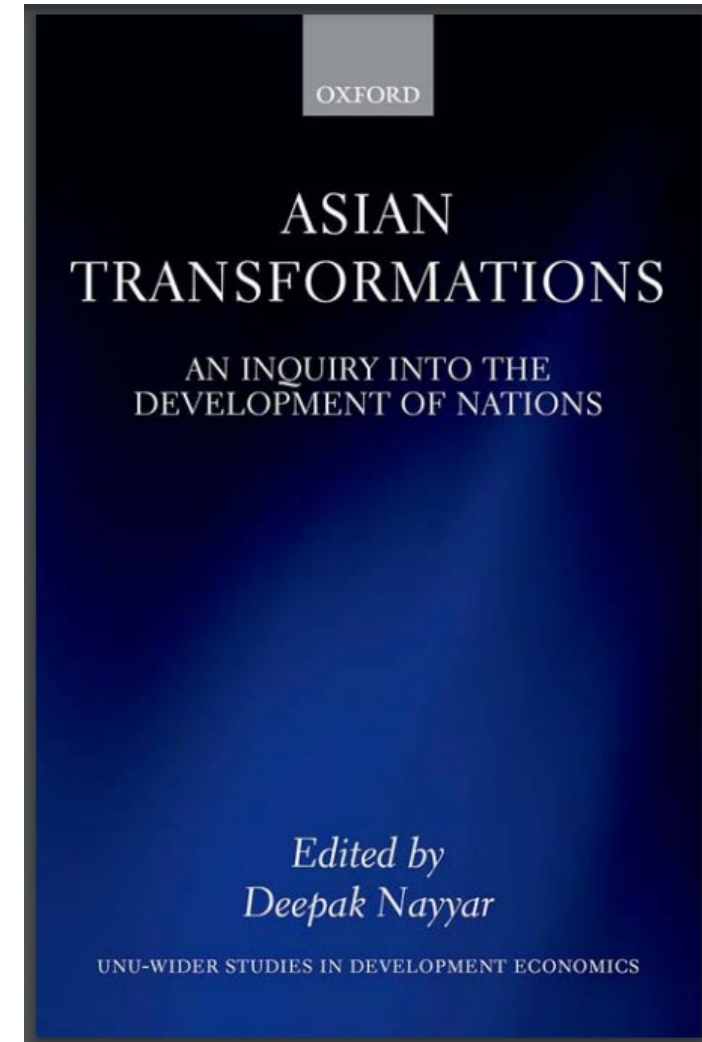
Corruption and governance and their role in policy implementation

Big bangs versus incremental reforms

# Policies, Institutions and Development: What have we learnt?

50 years later Deepak Nayyar evaluated how the 'Drama' had become a story of uneven 'Transformations' and summarized the state of our current knowledge:

- a) The *same* policies and reforms have often had very different outcomes: transformative in some cases but not others
- b) Countries often used *different* policies to successfully achieve similar goals
- c) *Designing* policies and reform strategies that are most likely to be effective in specific contexts remains a challenge



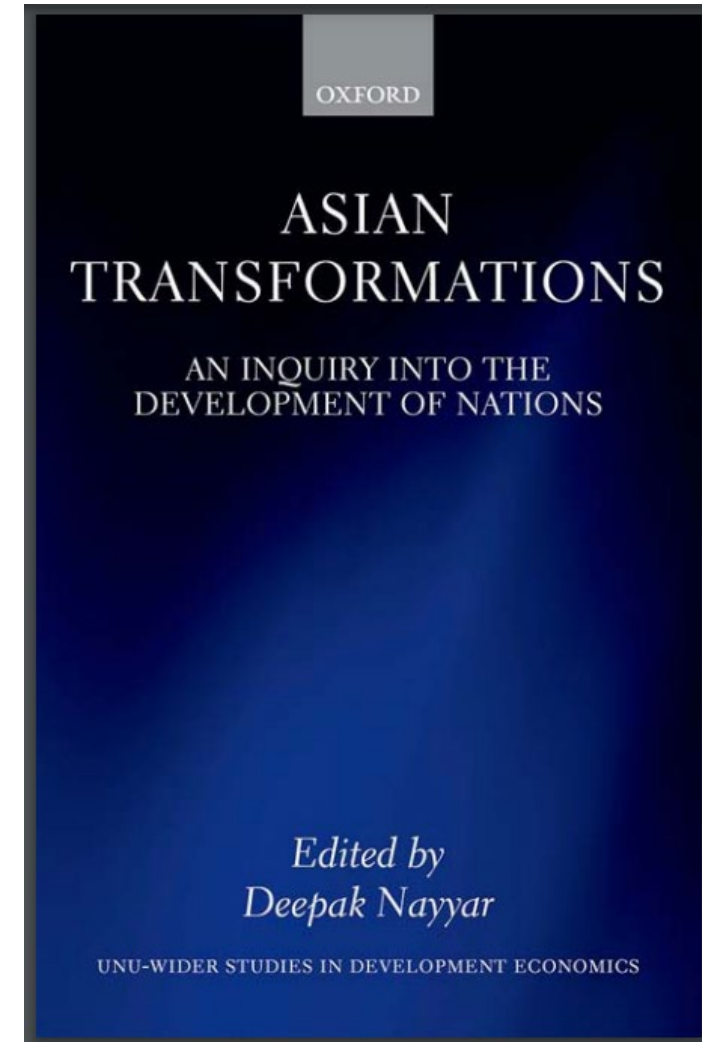
# Policies, Institutions and Development: What have we learnt?

1) At its heart the challenge is to identify the factors that *explain variations in results*: is it leadership, the interests of the ruling coalition, culture, supporting institutions...?

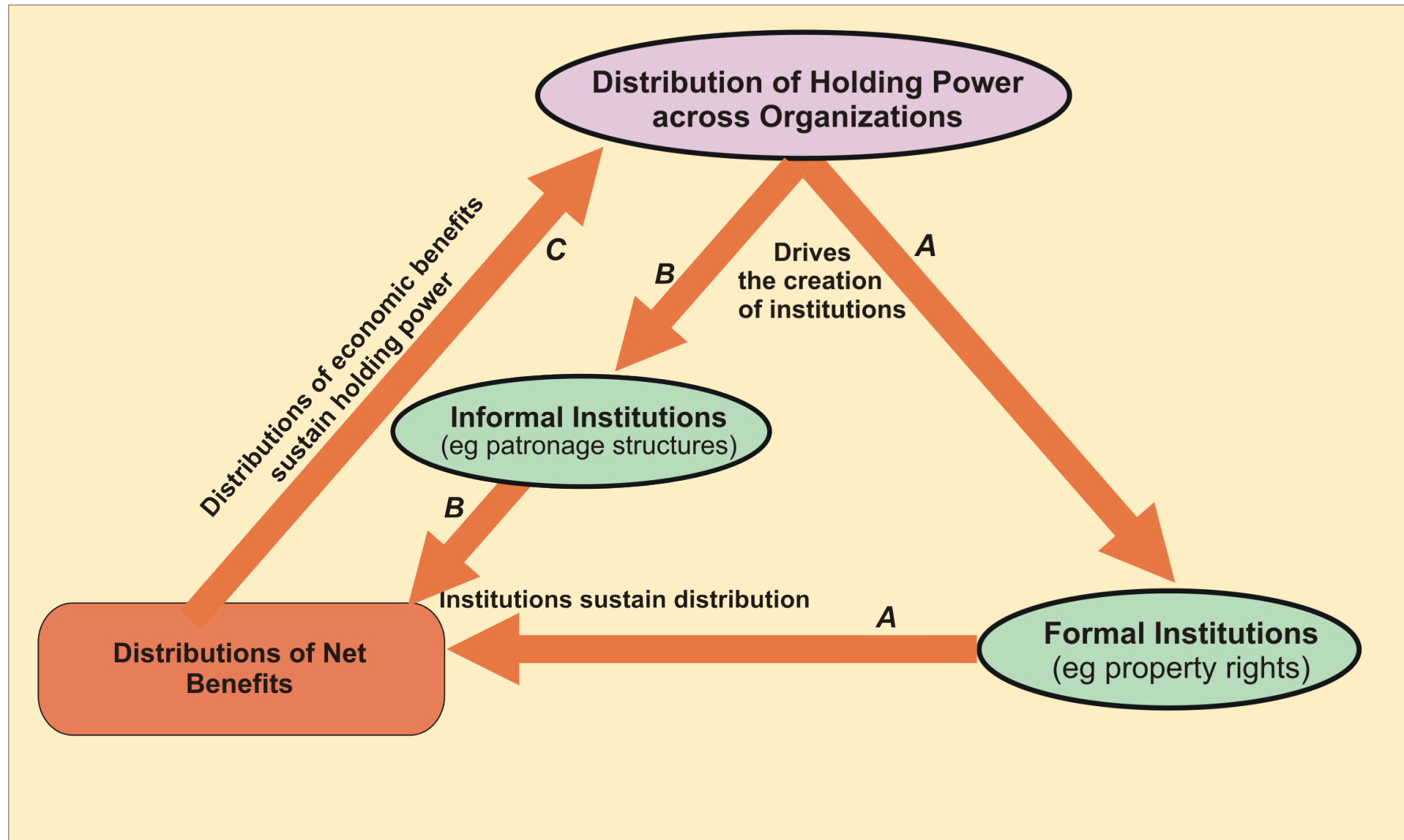
(This is more difficult than it sounds and has involved the use of both inductive and deductive methods... and many controversies)

2) The 'political settlements' approach that I develop says that the degree of adherence and enforcement requires looking at the endogenous *interaction* of institutions and organizations

3) A critical variable is the **historically inherited** power and capabilities of the *organizations directly* involved: and this is the relevant 'political settlement'



# 'Political Settlements' and the Enforcement of Formal Rules



## Policy Implementation with a Rule of Law

**Asymmetric Information** and **Collective Action** problems are important sources of enforcement/implementation failures

Focusing on the AI problem, improving transparency and accountability systems should reduce *this* problem

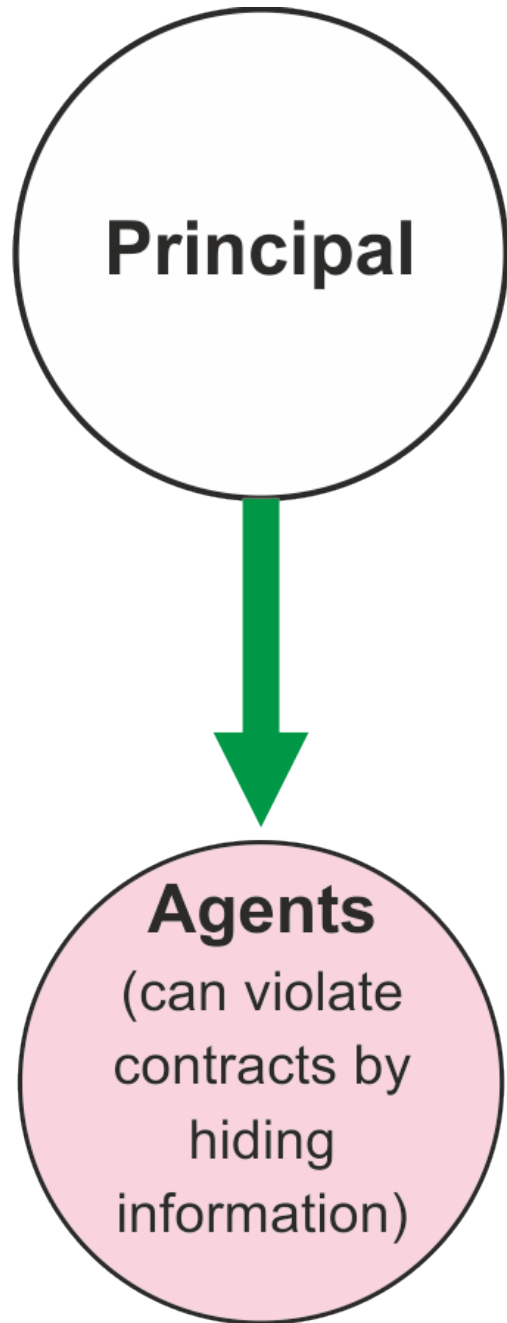
But in practice, this often does not happen in developing countries, leading to the Myrdalian response that ‘principals’ are ‘unprincipled’

This shifts our focus to culture, social norms, ethics, etc...

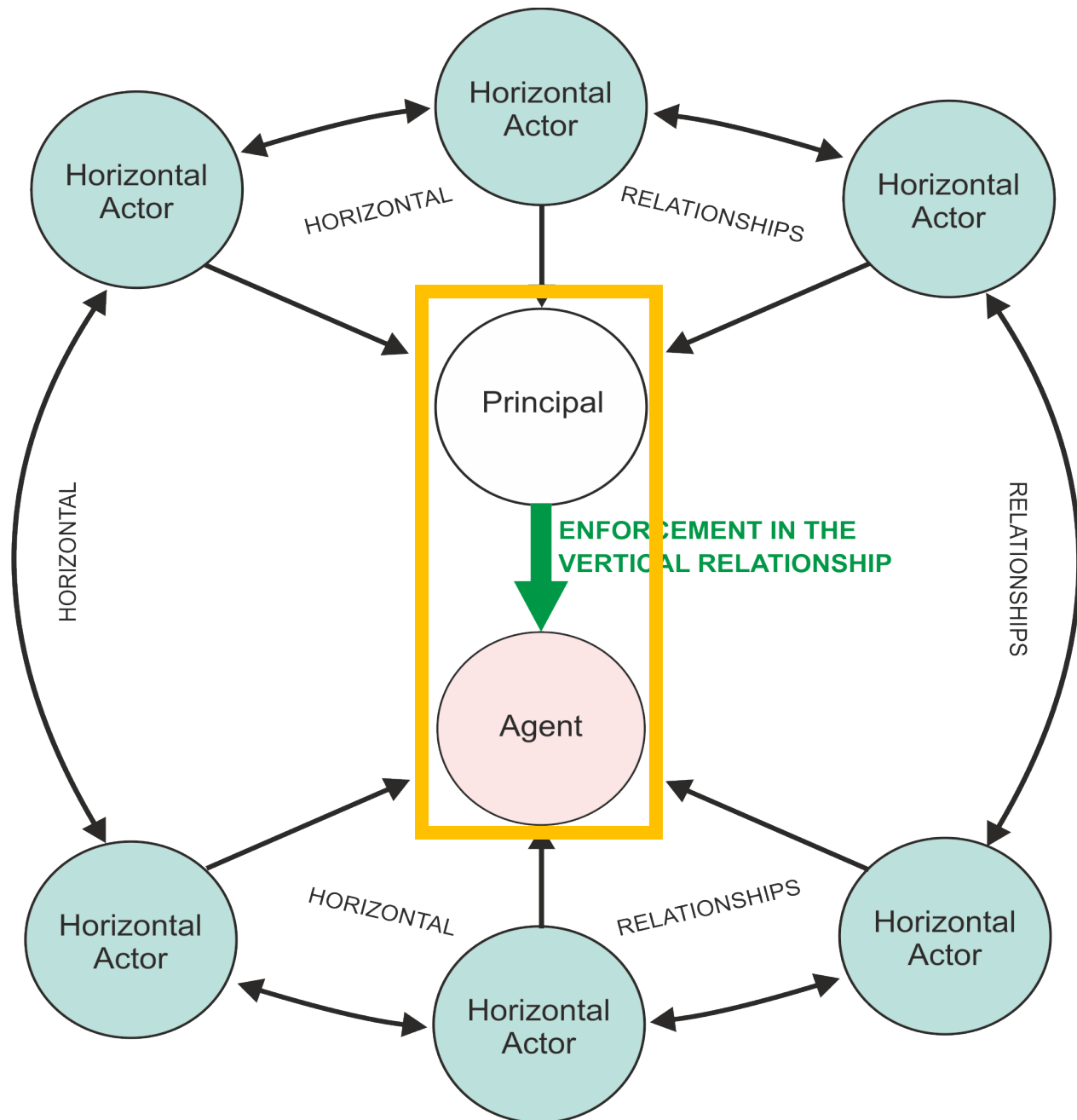
While these may be contributors, the more important problem may be somewhere else

An individual or organization’s behaviour often depends upon what those around them **can and will do (their power and capabilities)**: the *effectiveness of horizontal checks*

Why do people stand in queues?



## Principals and Agents are ALWAYS Embedded in Horizontal Relationships



The ***Power, Capability*** and ***Interests*** of 'horizontal actors' affect the behaviour of principals and agents

If enough horizontal actors **check** violations, rules are enforced:

A **Rule of Law** emerges when this is true across sectors: and then standard governance approaches of transparency and accountability work

Otherwise outcomes are sector-specific from **partial enforcement** to **entrenched corruption**

This can be in the same country and with the same principals, depending on the actors and the policy design



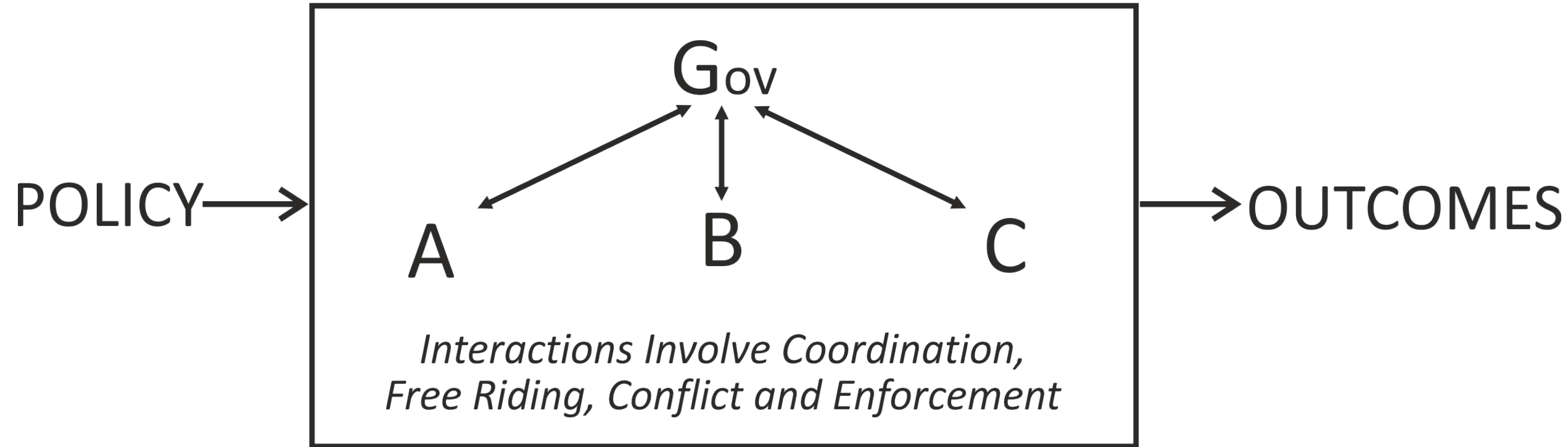
Policy aims to change organizational behaviour with regulations, taxes, subsidies, etc.

But expected outcomes often fail to materialize if policy fails to predict how organizations will respond (for instance by capturing the policy and policy rents) to reduce their own effort and/or to enhance returns in unproductive ways

Example: Industrial policy using **industrial development banks, tariff protection, and export subsidies** provided 'policy rents' to companies to finance new technologies and enable learning by doing. But what if they consume this without raising productivity?

Step 2: Governance theories: Focus on GOVERNANCE AGENCIES (Gov in the diagram below)

## ORGANIZATIONS



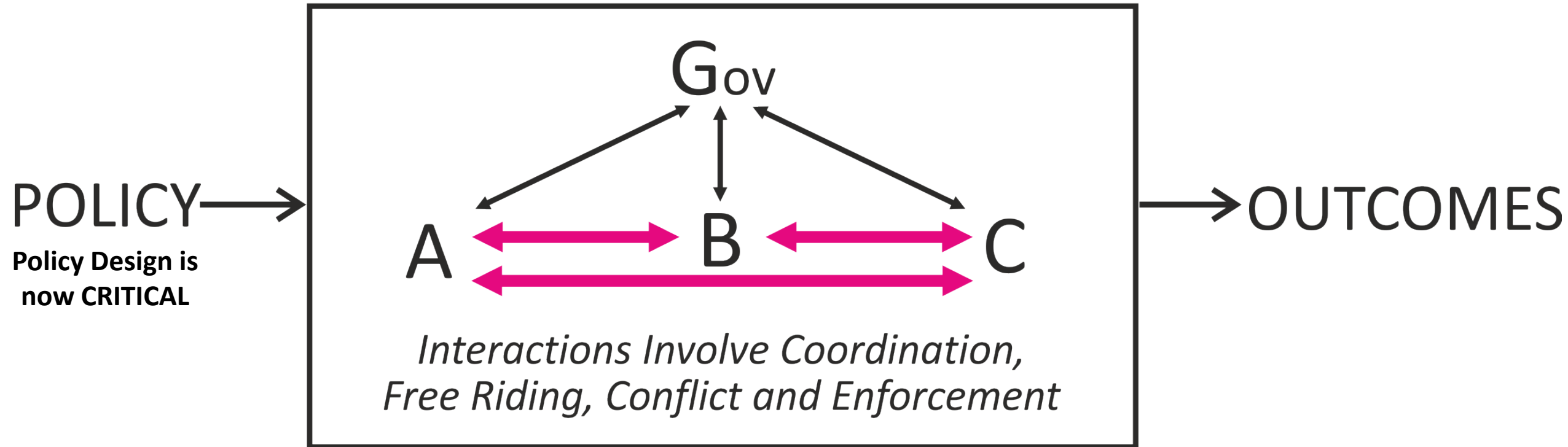
**Liberal** theorists focused on the capacity of governance agencies to enforce 'good governance', the rule of law, anti-corruption, property rights, political stability

**Developmental state** theorists looked at state capabilities of enforcing discipline, the vision of the leadership, and whether governance was Weberian (impartial) in enforcing rules

Both were looking at different types of vertical enforcement but improvements in these capabilities did not always lead to improvements in poor performers

## Step 3 PS analysis: Power, capabilities and Horizontal Checks across organizations

# ORGANIZATIONS



The **relative power of critical actors and their 'horizontal' activity to enforce or subvert rules** can determine how well particular rules are enforced, **given current governance agencies**

Policy **design** matters because it determines which organizations get rents and on what terms

This helps explain why **conventional** industrial policy worked in S Korea but **not** in S Asia

And why very **different** industrial policies that reduced risks in learning processes using *ex post* rents worked much better in South Asia (Bangladeshi garments, Indian automobiles, pharma)

## Example: Industrial Policies in East Asia and South Asia

1960s industrial policy were very similar in South Korea and Pakistan (in fact South Korean policymakers used to come to Pakistan to learn industrial policy!)

Export subsidies to large conglomerates, low interest loans, import protection, allocations of land, high concentration of businesses in a few holding companies

These policies provided large *ex ante* policy rents to large conglomerates who were expected to use this to raise productivity, increase exports, increase employment and soon become so productive that they did not need protection

This happened in South Korea, but not in Pakistan (and most developing countries)

Why did very similar interventionist policies have such different outcomes?

Moreover, South Korea at that time did not have a good rule of law, it had high levels of corruption, and limited democracy, like Pakistan

And the Pakistan state proclaimed a commitment to development, and tried to put pressure on the '22 families' to repay their loans and invest

## Example: Industrial Policies in East Asia and South Asia

The political settlement story points to difference in the power and capabilities of firms, parties and bureaucrats and the effects of Japanese versus British colonialism (see my chapters in my *Rents and Rent-Seeking* book and *Political Economy of Industrial Policy in Asia & Latin America*)

In South Korea, horizontal relationships between actors meant businesses could not form coalitions to protect rents

This gave the state the 'capacity' to remove subsidies from non-performing companies, and even to transfer entire plants from one chaebol to another, creating high level of compulsion for learning

Pakistan did not have such a political settlement: firms, politicians and bureaucrats could form coalitions to protect their rents regardless of outcomes

As a result in one case corruption was 'profit-sharing' with extraction hidden by genuine and sustained productivity growth, in the other it was 'subsidy-sharing', generating unsustainable short-term growth and actually protecting inefficiency

## Bangladesh's garment industry

- The Multi-Fibre Arrangement or MFA of 1974, created potential extra profits for LDC garments firms if they could achieve a certain level of productivity
- The Dosh-Daewoo agreement of 1979 exploited this opportunity successfully by creating strong and credible incentives for Dosh to learn these capabilities
- But learning faced market failures and required *some* types of policy support
- Dosh had the money to invest in a large modern garments factory but it lacked the organizational capabilities for competitiveness
- Daewoo invested in capability development to be able to sell its fabrics and hosted 130 Bangladeshis at its factory in Busan to learn on site
- Daewoo's prize was an 8% royalty on the eventual sales of Dosh, which Dosh could earn because of the MFA quota rent
- But Daewoo could not get the rent unless the domestic producer became (at least close to) competitive (in this case it could not export otherwise)

## Bangladesh's garment industry

- Given Bangladesh's political settlement, the effective policy design here was the conditional rent transfer from Desh to Daewoo (implicitly backed by the state) and thereafter the two actors *checked each other. Neither could violate the rules*
- The results were spectacular. Competitiveness was planned in two years but was achieved in less than one
- Desh grew at close to 100% a year; of the 130 mid-level managers who went to Busan, 115 set up their own factories within two years
- Bangladesh became the second largest garments exporter by the 2000s
- This shows that effective policy design for difficult policy goals is possible if policy design can exploit power, capabilities and interests to generate horizontal checks
- Desh was successful because a) it had the capabilities and interests to develop a competitive business, b) the policy framework gave it resources, but c) in a way that resources could not be misused because another powerful and capable firm, Daewoo was checking it out of its own interest.

## Policy Design for Development

- There are two escapes from Myrdal: the long-run one is indeed to strengthen the rule of law but that requires a broad distribution of power and capabilities
- The immediate one is to design policies that achieve developmental objectives by simultaneously creating incentives for horizontal actors to check each other
- All successful policies in developing countries have elements of this
- In the SOAS-ACE research programme (<https://ace.soas.ac.uk/>) we identify many examples of how horizontal checks are already working to reduce resource leakages and feasible strategies for enhancing and developing these checks
- Finally, none of this is news to people in the real economy
- We should learn from how businesses do business in developing countries – they do not entirely rely on contracts and formal enforcement but spend a lot of time on ensuring the effectiveness of horizontal checks
- Formal policy-making needs to replicate this

For further reading

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My work is available on

<https://www.soas.ac.uk/staff/staff31246.php>

and

<https://ace.soas.ac.uk/>