Chapter 5

The Intrinsic Difficulty of Distinguishing Between Good and Bad Policies

A surprising consensus now exists among economists that there is "no one way to do things." As far back as 1979, the IMF's Guidelines on Conditionality stressed the need to avoid blueprint approaches, pay due regard to individual political and economic circumstances of particular countries, and keep the number of conditions attached to loans to a minimum. The World Bank (2005, p. 22) recognised in its 2005 *Conditionality Review* that "the lessons of the 1990s show that generalised policy prescriptions often fail, and that there is no single model of development." Such declarations cut across ideological divides. Stiglitz (2005, p. 1) observes "if there is a consensus today about what strategies are likely to help the development of the poorest countries it is this: there is no consensus." Feldstein (1998, p. 5) makes a similar point:

> "Imposing detailed economic prescriptions on legitimate governments would remain questionable even if economists were unanimous about the best way to reform the countries' economic policies. In practice, however, there are substantial disagreements about what should be done."

Notwithstanding declarations like these, which have now become commonplace, the economics profession arguably still tends towards excessively reductionist and prescriptive approaches to economic problems. Underlying this is the basic methodological approach to which most economists ascribe: it is difficult to reconcile the search for universal rules which govern economic phenomena with the idea that a broad palette of effective development strategies exists. And the issue is important because professional economists often heavily influence the formulation of policy towards developing countries.

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One could take these arguments further and argue that the ideals of good governance and good policies are flawed by their essentially ephemeral character. In economic policy making "good" and "bad" are words that express current value judgements of individuals, interest groups and entire polities. Thus, no immutable set of policies deemed "good" can exist; any consensus changes over time. The Washington Consensus, thought definitive when first elaborated in 1989, offers a good illustration: it has subsequently seen substantial modification, and some people now speak, tongue in cheek, of a post-post Washington Consensus (Table 5.1)[1] .

Table 5.1. **The Washington Consensus and the Augmented Washington Consensus**

Original Washington Consensus	"Augmented" Washington Consensus: the previous ten items, plus:
1. Fiscal discipline	11. Corporate governance
2. Reorientation of public expenditures	12. Anti-corruption
3. Tax reform	13. Flexible labour markets
4. Financial liberalisation	14. WTO agreements
5. Unified and competitive exchange rates	15. Financial codes and standards
6. Trade liberalisation	16. "Prudent" capital-account opening
7. Openness to FDI	17. Non-intermediate exchange rate regimes
8. Privatisation	18. Independent central banks/inflation targeting
9. Deregulation	19. Social safety nets
10.Secure Property Rights	20. Targeted poverty reduction

Source: Rodrik (2006).

Given its import for debates on conditionality and the delineation of the "right set of policies", this point is worth dwelling on. Even when there has been near unanimity about appropriate economic policies, the consensus has changed radically (Feldstein, 1998, p. 5). The IMF, for instance, was created to defend and manage a fixed exchange-rate system now regarded as economically inappropriate and practically unworkable, yet it still plays a key role in a transformed international monetary system. Similarly, for a long time, advice to developing countries from the World Bank, the Economic Commission for Latin America and the Caribbean (ECLAC) and leading academic specialists emphasised national plans for government-managed industrial development. Now the consensus urges opposite policies: flexible exchange rates, market-determined economic development and free trade. As we shall see in Chapter 8, the current financial crisis has made these inconsistencies even more self-evident.

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All this puts professional economists in a difficult position with regard to issuing policy advice. Tarp (2001, p. 342), for instance, concedes that he has "always been worried about being caught up in the latest World Bank fads. The boundary between policy advocacy and policy research is not always clearly delineated and over the years we have seen many shifts of direction and emphasis in the policy advice and lending emanating from the World Bank". One notorious example of how the donor community has done a u-turn on policy was the pressure placed on many low-income countries in the 1980s and 1990s to introduce user fees in health and education services, a policy now widely recognised as extremely counterproductive. Donors on the one hand acknowledged the importance of expanding social expenditures and on the other obliged countries to undertake "fiscal tightening" – a difficult task to reconcile in any case. But then, through the introduction of fees, they pursued policies which ultimately restricted the access of the poor to those very same services. By 1995, 28 of 37 countries in Africa had introduced fees for basic healthcare. As late as 1998 some 75 per cent of World Bank loans to Africa still included the establishment or expansion of user fees. In Zimbabwe, the use of health facilities fell by 25 per cent in three years following the introduction of user fees, while child mortality rose by 13 per cent. The effect was similar in Ghana, the Democratic Republic of Congo, Swaziland and Lesotho (Glennie, 2008, p. 43). Acknowledgement of error and a subsequent change of policy is of course a positive thing, especially when adapting to new circumstances. Indeed, few policy frameworks shift more frequently than aid policies. But the fact that this received wisdom changes so often should at the very least provide the motivation for a serious reassessment of policy conditionality.

Giving more policy space to the developing countries themselves would surely be a better approach. As the communiqué made at the G8 summit at Gleaneagles in 2005 suggested, "it is up to developing countries themselves and their governments to take the lead on development. They need to decide, plan and sequence their economic policies to fit their own development strategies, for which they should be accountable to all their people" (cited by UNCTAD, 2008, p. 93). Yet according to the World Bank (2007), no least developed country (LDC) yet has a "sustainable" operational development strategy and only six of the 37 LDCs have "largely developed" ones[2]. And although PRSPs fall far short of comprehensive development plans, it is in any case somewhat ironic that donors and the IFIs now promote "development strategies" when much of their effort in the 1980s and 1990s worked against the idea of any kind of planning, and that to most mainstream economists planning has become an anathema.

The difficulties surrounding indexes like the World Bank's Country Policy and Institutional Assessments (CPIAs) illustrate the intrinsic problems of determining when policy is "good" or not. The CPIAs are used as guides for concessional lending policies (most notably by the International Development Association [IDA]) and many analysts consider them among the most carefully constructed sets of governance indicators. Bank staff follow specific guidelines to rate and benchmark countries in each region. They currently assess and rate 16 policy and institutional performance areas every year, grouped and averaged into four clusters: *i)* economic management; *ii)* social inclusion and equity; *iii)* public sector management and institutions; and *iv)* structural reform policies.

As a key tool in the application of conditionality, it would be foolish to underestimate the importance of the CPIA. The World Bank's CPIA has also been used as a model for other development banks, such as the African Development Bank which now produces its own CPIA, and many other donors use the World Bank´s analysis to make their own decisions about where to target aid. As a consequence, if a country scores well on the CPIA criteria it is likely to see aid increase – if it scores badly, it will find it harder to access funds. In this way, the CPIA inadvertently contributes to creating the cleavage between "aid darlings" and "aid orphans". According to the World Bank's own data (IDA, 2003, p. 8) the countries in the top performance quintile ("strong performers") received on average four to five times more IDA aid per capita than the countries classified in the bottom quintile ("poor performers"). Another major shortcoming for aid recipients has resided in the CPIAs' lack of transparency. Until 2006, the scores given to particular countries remained secret and confidential to the World Bank (Arndt and Oman, 2006, p. 40; Riddell, 2007, p. 234). More pointedly, perhaps, only fairly ambiguous correlations appear between economic growth and the various components of the CPIA, particularly public-sector management and institutions (Figure 5.1), suggesting some serious limitations in the CPIAs as tools for measuring policy effectiveness, even on traditional grounds of generating economic growth, let alone for achieving poverty reduction or human development.

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Figure 5.1 **GDP per Capita Growth and Country Performance (CPIA) by Policy Area, FY1996-2001**
3 year average growth in GDP per capita

Source: World Bank (2007, p. 189).

One fundamental issue not addressed in the elaboration of policy performance indexes like the CPIA is the correct sequencing of policy implementation. Poor economies suffer from a variety of afflictions related to poor human capital endowments, the ineffective use of capital and other resources, poor institutions, unstable fiscal and monetary policies, inadequate private incentives for investment and technology adoption, poor access to credit, poor integration with world markets and so on. Rodrik (2007, p. 89) emphasises, "To say that one has to overcome all these disadvantages in order to develop is at once a tautology and quite unhelpful…the trick is to find those areas where reform will yield the greatest return, or where we can get the biggest bang for the reform buck. What we need to know, in other words, is where the most binding constraint to growth lies." In the tradition of the second-best theorem, the theoretically best solution to a given economic problem may not always provide the biggest welfare payoff[3]. It is thus important to analyse the

possible trade-offs between different policy options. Yet donors often refrain from doing so, preferring simply to identify long lists of policy requirements (what is sometimes referred to as "the laundry-list approach" to policy making). For example, in the late 1990s, the World Bank, an organisation with "plenty of ideas but no priorities", set 111 conditions in its policy framework paper for Kenya alone, a trend which Edwards (1999, p. 118) describes as "conditionality gone mad". World Bank economists Pritchett and Woolcock (2004, p. 192) make some particularly adroit observations on this issue:

> "Most agree the debate about the Washington consensus is blown far out of proportion. At times 90 per cent of the ink spilled addresses 10 per cent of the development battle; in the end, no matter who is right about trade policy, fiscal deficits and the like, these policies do not add up to anything like a complete development agenda .... Policies such as trade openness, fiscal probity, etc. need to be seen as part of, not a substitute for, a coherent development strategy. Even the 'augmented Washington consensus' that adds the provision of some key services (such as education) to the standard policy agenda leaves wide open the standard policy question of how things will actually be accomplished. In general economists have focused their tools on the question of what governments should do, with relatively less attention given to the economics and politics of how to accomplish the 'what'."

In a generally overlooked, but deeply insightful book, Atul Kohli (2004, p. 12) notes that:

> "The nearly exclusive focus in the literature on appropriate policy choices is incomplete, even misleading. Policy choices matter, of course, but these choices must be explained. More important, the impact of the same policy applied in two different settings may vary because of the contextual differences, some of the more obvious being varying global conditions and different initial conditions of an economy."

From this point of view, there is no one correct or incorrect policy. As the *New Aid Agenda* fortunately recognises increasingly, implementation is key. If this diagnosis is right, development policy must engage in realistic evaluations of policy options – in other words, a return to political economy. Peter Nolan (2004, p. 97) argues quite rightly that, "Far too often, economic advice has been little more than slogans. Too rarely has it consisted of careful, pragmatic political economy". This implies that policy conditionality has become largely obsolete and that donors need to explore other ways to maximise the efficiency of their aid money.

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Notes

1. The intellectual confusion around the relationship between policy and development is revealed by the contradictions evident in the overview to a major World Bank study (Devarajan *et al.*, 2001). On page 2 the authors claim that "we know enough about development policies to make a fair assessment of the quality of policies across countries and over time", but this affirmation squares particularly badly with the admission on page 33 that "we simply do not know what is good policy, and the issue for donors is to support genuine policy learning rather than to impose models through conditionality".
2. These countries are Burkina Faso, Ethiopia, Rwanda, Tanzania, Uganda and Zambia.
3. As Toye (1993, p. 96) explains, intuitively one can see that unless an economy suffers from only one distortion, or departure from the requirements for perfectly competitive behaviour, there is no guarantee that removing the distortion would produce an increase in welfare. Two or more distortions might partially or wholly cancel each other out, and thus their removal might make the economy more inefficient than it was before. As Toye notes, "given that, in the real world, economies rarely suffer from just a single distortion, the theorem seems to mean that there is no way of knowing whether piecemeal attempts to introduce perfectly competitive markets will raise or lower welfare. The second-best theorem seems to lead to policy agnosticism".

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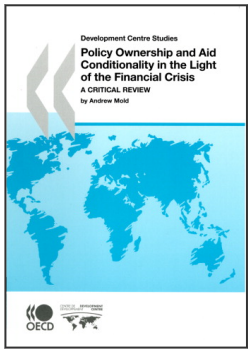

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