The Role of Bespoke Policymaking in Sustaining Economic Growth

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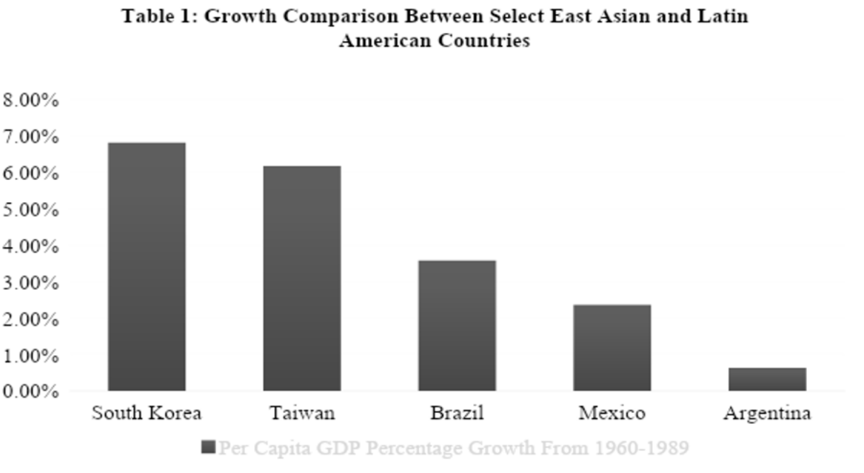
In this paper, James Burne espouses the virtues of creating specific rather than universal solutions to the economic problems facing less developed countries. The piece explores historical approaches to development and highlights the areas in which there have been missed opportunities for better policy approaches. Burne argues for more individualised frameworks for developing countries through the implementation of the growth diagnostics model, and analyses the concept of institutional monocropping. Ultimately, the paper outlines the argument for moving development away from past standardised reforms to a method founded in identification of individual problems.

Introduction

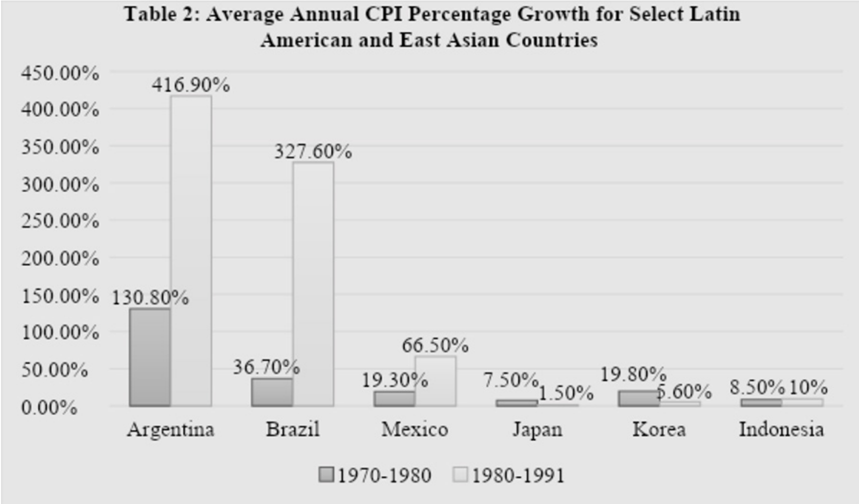
The process by which reforms are undertaken in developing countries to allow for economic growth is a delicate matter. If such reforms are effective and implemented correctly, then developing countries will establish a foundation upon which further growth can emerge. However, standardised reforms, the imposition of policies and values which have proved effective in developed countries, has undercut growth efforts. Hence, while generalised reforms such as the Washington Consensus and institutional monocropping were theoretically designed to promote development, they are ill-suited for the requirements of developing countries and have often resulted in backsliding. Therefore this paper will examine how bespoke policy achieved through the growth diagnostics framework and self-discovery are more conducive to growth than generalised reforms, and how such policy can promote sustained development. While one cannot completely reject the merits of standardised policies, such objectives must be achieved by countries that establish their own model of best fit for growth, not by adopting a pre-established one.

The Origins of the Washington Consensus

The policies adopted during the period of the 1950s marked a divergence between developing countries. Latin American countries employed import-substitution strategies to protect and develop their national industries. Conversely, East Asian countries such as Taiwan and South Korea focussed on developing their export industries through structural market reforms (Rodrik, 1996). One can observe a substantial regional difference in the growth of GDP per capita from 1960-1989 because of these different policies in table 1 (Rodrik, 1996). While Argentina achieved growth of less than one per cent, the 2.36% growth of Mexico is modest in comparison to the 6.82% of South Korea. Hence the fundamental differences in success between those who adopted market-based reforms and those who did not are evident, thus demonstrating the economic logic behind them. When one considers the failure of these import-substitution strategies together with the consequences of the lost decade of growth from 1980 to 1990 it is evident why Latin American countries would seek market reforms akin to those which brought success to the Asian tigers. For example, while many Latin American countries had high levels of inflation growth going into the 1980s, as indicated by the CPI, inflation growth in Brazil can be observed to be almost three hundred per cent greater in the 1980 to 1991 period than it was from 1970 to 1980 (Jaspersen, 1997 table 2). Conversely, one can observe that the East Asian countries in question witnessed a decline in the growth of inflation during the same periods and remained internationally competitive as a result. Thus, one can understand the desire for growth inspiring reforms given such failings.



Source: Rodrik (1996, pp. 13). Primary source: Penn World Table 5.5 (1993).



Source: Jaspersen (1997, pp. 76). Primary sources: World Bank, World Tables, 1982, 1987, and 1993.

The Washington Consensus responded to such growth failures in a series of reforms and development strategies designed to reignite growth. The Consensus is composed of ten market-orientated policy reforms designed to alleviate distortions that inhibit growth based on Western experience (Williamson, 2008). The ten reforms detailed in table 3 (Fischer, 2012) make sense under the logic of economic growth and the market-based policies which have been observed to work, for example fiscal discipline to reduce the balance of payments crises. The development of competitive exchange rates in the 1960s by South Korea and Taiwan (Rodrik, 1996) allowed their exports to compete with western rivals and their industries to grow. The establishment of such a regime in Latin America in addition to reforms such as trade liberalisation and increased FDI would theoretically create a competitive environment for domestic producers. Hence such reforms granted developing countries the opportunity to grow in a manner that would not have existed otherwise by providing guidance. Hence such reforms appeared to set Consensus adopting countries up for economic success.

Elements of the Washington Consensus	Summary
Fiscal discipline	Low deficits to prevent a balance of payments crisis
Public expenditure priorities	Developing infrastructure and public services
Tax reform	Establish a coherent tax base
Interest rate liberalisation	Government limited to supervision
Competitive exchange rate	Valued correctly to increase competitiveness
Trade liberalisation	Reduced barriers to trade overtime
FDI liberalisation	Increased foreign competition and investment
Privatisation	Removal of government involvement to increase efficiency
Deregulation	Reduced barriers to entry and exit
Secure property rights	Legally secured to incentivise investment

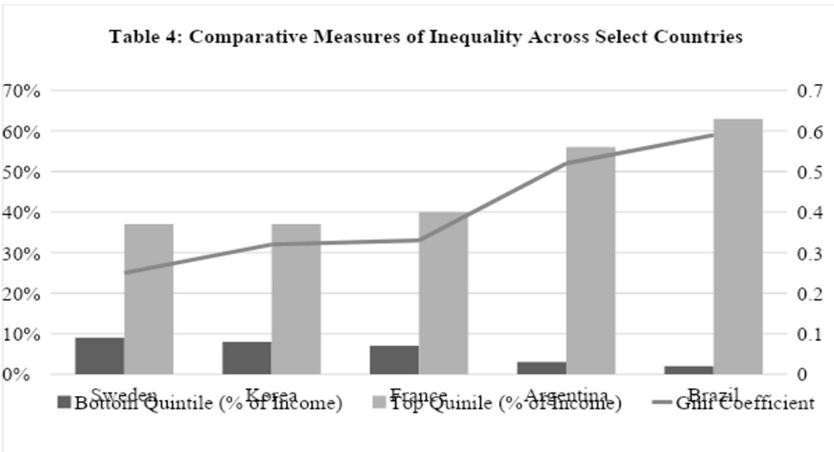
Table 3: The Washington Consensus
Source: Fischer (2012 pp. 13). Primary source: Williamson (2008).

The Washington Consensus Versus East Asia

While growth was slow to occur the Consensus had real effects. In addition to sharp declines in the share of countries with extreme inflation and bad policies (Easterly, 2019), from 1970 to 2015 countries that implemented the Consensus experienced a level of growth in five-year periods which was 2.07% to 2.87% higher in comparison to similar countries that did not implement the reforms (Grier and Grier, 2020). However such growth could be considered low given the high costs required to achieve the Consensus' reforms. However one can conclude that generalised policies have allowed for economic reforms which have facilitated growth, albeit slowly. However, while generalised policies do have a place in shaping growth one must also consider the dimensions in which generalised reforms failed.

Effective reforms must resolve underlying social issues to establish a foundation for consistent growth. For example, East Asian policies targeted income inequalities to enable an even distribution of resources (Jaspersen, 1997). Such a reduction allowed for an overall increase in education levels and therefore improved human capital. The expansion of human capital facilitated a higher level of growth which in turn reduced disproportional distribution. As such outcomes reinforce each other (Jaspersen, 1997), one can conclude that establishing policies that resolve underlying issues allows for growth to be developed on a stable foundation. While many Latin American countries lacked or employed a weaker version of the above policy (Jaspersen, 1997), one can observe that the Consensus did not expand upon inequality reduction. As the Consensus focussed on solely increasing GDP and not shared growth like East Asia did (Todaro and Smith, 2015 chapter 11), it provided little room for policymakers to to resolve underlying social issues. Thus by neglecting such social issues reforms have been less efficient than their Asian counterparts. Such differences in policy outcomes are reflected in table 4 (Krugman, 2008) where the Gini coefficient of Korea in 1998 was close to European counterparts at 0.32, whereas Argentina and Brazil in 2001 held values of 0.52 and 0.59 respectively, therefore indicating higher income inequality. The share of income held by the upper and lower quintile reinforces these observations. When one further considers the respective average GDP growth rates from 1960 to 1994 of 8.5% and 8.7% for South Korea and Taiwan, who did not readily follow the Washington Consensus, in contrast to Latin America's average of 4.2% (Collins and Bosworth, 1996), one can conclude that the paths forged by East Asia did not limit their growth, but rather liberated their potential when considering the restrictive nature of the Consensus in contrast to the development of policies that befit specific economic requirements and sustained growth. Therefore, while the Consensus did resolve key market distortions, its framework could not resolve fundamental issues due to its shallow penetration.

Source: Krugman (2008, pp. 34). Primary source: World Bank WDI database.



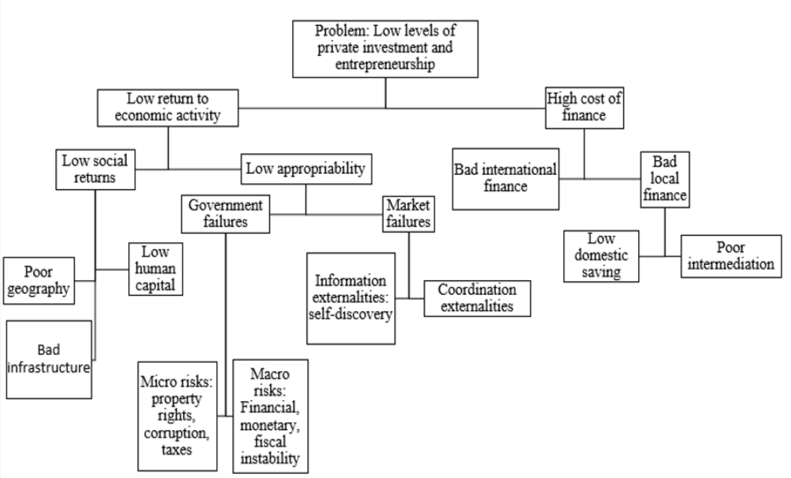
Growth Diagnostics and Bespoke Policy Making

Considering the weaknesses of standardised reforms one can examine the ability of the growth diagnostics model to create bespoke policies that allow individual countries to forge their own path towards sustained growth. The model allows countries to identify and develop policies to target the most binding constraint to growth (Hausmann, Rodrik, and Velasco, 2008). The logic behind targeting the most binding constraint is to allow for reforms that provide society with the largest marginal benefit possible as removing such hindrances paves the way for future development (Hausmann et al., 2008).

One can contrast this to the Washington Consensus where its numerous and more general reforms did not allow for such prioritisation and thereby may not have targeted a country's most binding constraint. Thus such a laundry list of reforms is less efficient as they are squandered on areas where they have little use as opposed to targeting areas that provide a higher level of welfare and have a significant multiplier effect.

One must first identify the largest constraint to growth using the growth diagnostics decision tree. From the tree in figure 1 (Hausmann et al., 2008) low economic activity can be identified by one of two problems: high costs of financing or low economic returns. By identifying which issue most accurately captures the economy one can then move down the tree to identify the binding constraint that is the root cause of the problem. For example, when facing low economic returns this could be caused by either low social returns or low appropriability. Thus the role of the model to identify the most binding constraint to growth and allow for policies to be constructed to resolve it. Hence growth diagnostics allows for a very accurate analysis of specific constraints and thus allows for reforms to avail of information that they would lack otherwise. One can observe that this process is a stark contrast to standardised reforms which are limited in impact if they do not prioritise the most binding constraint and lack the information necessary to tailor policies based upon how significant an issue is.

Figure 1: Growth Diagnostics Decision Tree



Source: Hausmann et al. (2008, pp. 326).

Once the binding constraint has been identified policies must be devised to target and minimise this distortion (Rodrik, 2008). As such policies specifically target the distortion in question one can observe the capacity of this model to construct policies that systematically build the foundations necessary for

for sustained growth. However, due to the sub-optimal conditions in which policymakers operate, a policy approach that may appear logical might only serve to further undercut growth. Thus Rodrik (2008) advocates the adoption of second-best policies that will better fit this second-best environment. Such policies can be observed regarding Chinese township and village enterprises, TVEs (Rodrik, 2006). As China lacked the judicial system required to secure institutionalised property rights, such rights were more secure under local governments. This guarantee encouraged investment in TVEs (Rodrik, 2006) and has contributed to rapid expansion in the number of TVEs from 1.5 million in 1978 to 23.4 million in 1996 (DaCosta and Carroll, 2001). Additionally, TVEs have increased their employment by approximately one hundred and seven million workers over the same period. Thus one can observe that TVEs and the bespoke policies which guided them have significantly contributed to the average annual per capita growth of eight per cent in China during these eighteen years (DaCosta and Carroll, 2001). Hence the binding constraint of poor property rights as identified in the decision tree was resolved by employing the second-best policy and was responsible for subsequent growth. One can contrast this to the Consensus which would not have considered the possible distortions of establishing formal property rights without the means necessary to enforce them. From this perspective growth diagnostics is considerably more adaptable, something which has proven to be vital providing the unique circumstances of countries.

Institutional Monocropping

For a country to maintain its bespoke reforms it must establish an institutional framework. The function of institutions is to allow for effective and meaningful interactions to transpire. In an environment that holds a high degree of uncertainty, it may be difficult to facilitate such interactions. Therefore the role of institutions is to structure the behaviour of actors to be predictable by incentivising and disincentivising certain actions (North, 2003). One approach to institutional reform is institutional monocropping. Monocropping involves taking institutions that have already been established and proven to work in developed countries and implementing them in a developing country (Evans, 2004). One can observe why this concept would be enticing to developing countries that are suffering due to their low-quality institutions. The adoption of standardised and universally accepted institutions can be viewed by developing countries as a superior alternative to local reforms which may fail in practice (Evans, 2004). This notion is reinforced by Rodrik (2000) who argues that there is room for standardised blueprints for assisting in the numerous technical issues that developing countries would otherwise be left to overcome alone. Therefore one can observe the desire to adopt such institutions considering that neglecting reform will hinder the sustainment of growth. Hence the implementation of standardised institutions will theoretically facilitate growth. However, again one can observe deficiencies regarding standardised reforms.

The failings of monocropping can be understood due to the differences in environments and understandings present in developed and developing countries. Both groups of countries operate under radically different preferences towards economic, political, and social structures. Hence, the notion that one can simply take one institutional form and baselessly apply it to all other countries regardless of their unique cultural issues or socio-economic position is bound to fail as this method does not cater to the pre-established dynamics of developing countries (Evans, 2004). For example, Mauritius, a small and divided society, was faced with the need to adopt export-orientated strategies while also employing protectionist measures to protect domestic industries (Rodrik, 2000). The standard institutional advice would have been to reform by liberalising the entirety of the economy. However, this advice did not consider how such institutional changes would have affected the already divided Mauritius. Instead, Mauritius established export processing zones, EPZs, to overcome its challenges despite how standardised advice would have advocated monocropping instead. The development of EPZs allowed policymakers to avoid worsening divisions while providing institutions based on cooperation, thus creating export opportunities and high levels of employment (Rodrik, 2000). One can observe that the creation of cooperative institutions improved governance, domestic investment (Rodrik, 2000), stability, FDI, and reduced external debt from 24% to 12.9% from 1981 to 2004 (Sobhee, 2009). While Mauritius has since diversified from EPZs towards ICT (Sobhee, 2009), it demonstrates how bespoke institutional reform can establish sustained growth when compared to monocropping. One can therefore conclude that a developing country cannot ignore the necessary steps of development as monocropping encourages. Rather they must establish their own bespoke approach to reform which incentives development instead of undermining it.

Conclusion

In conclusion, the effects of generalised and bespoke policy making in relation to economic development have been established. The Washington Consensus has evidently contributed to the reduction of distortions such as inflation and bad policymaking while institutional monocropping has provided some blueprints for institutions. However, such generalised reforms have overall proven to be inefficient in terms of sustaining growth when contrasted to the ability of the growth diagnostics framework to target binding constraints and the importance of self-discovery regarding institutional reform. Hence while one can draw inspiration from generalised reforms it is ultimately the task of bespoke policymaking to build the foundations upon which further growth can be achieved. Therefore, policy should enable countries to overcome their unique internal struggles and build upon this as the West once did for growth to be sustained.

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