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From Transformation to Development: Globalisation and Perspectives for Economic Policy

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Summary

For over two decades, economic reforms have been underway, reducing state involvement in the economy through privatisation, lowering barriers to foreign trade and investment and allowing market forces to guide resource allocation to a much greater extent. The process began in the OECD area, before spreading to developing countries after the Cold War. It is now accelerating thanks to information and communications technologies.

National choices have been increasingly limited by international co-ordination schemes, of which the European Union is the most ambitious, both in its depth and in the width of its membership. Co-operation is also intensifying within civil society. Non-governmental organisations from a whole range of perspectives, including civil rights, business and labour, are monitoring governments and corporations increasingly closely.

Transition and development studies have deepened and broadened, both help understanding social transformations. More than transition, development implies a forward-looking perspective on the global economy, and even countries as large as China or India are not immune to the pressures of globalisation. The problems of growth and social cohesion, of income distribution and of skills acquisition and allocation reflect in their own way the combined pressures of globalisation and governance (G&G). For transition countries, like for most others, development builds on G&G.

[1] The paper is based on a lecture delivered by Professor Jorge Braga de Macedo on March 30, 2001, at the Leon KoŸmiñski Academy of Entrepreneurship and Management, Warsaw, Poland. The original transcript is available at www.fe.unl.pt/~jbmacedo/oecd/warsaw.html

Development problems and transition problems gain in being looked at together. Development is a branch of economics that has had a special fate. In the post-war period, there was great enthusiasm about development as a field, almost separate from economics. That it was a special field relative to mainstream economics created kind of a bad name for development economics. After the initial enthusiasm, the question was, of course, why should there be economics for some countries and then development economics for other countries. It was a little bit strange.

Fortunately, development, which had become a marginal field, came back in full force at the time of the transition from plan to market. We can date this return to the mainstream as we want, but the 1985 Marshall lecture by Bob Lucas, who ten years later was awarded the Nobel Prize in economics, is as good a milestone as any. There he defined the problem of economic development as “the problem of accounting for the observed pattern, across countries and across time, in levels and rates of growth of per capita income” (Lucas, 1988). In other words, he was concerned about the way people and nations get rich. This is the traditional message of economics, nothing special about it. But, as I will stress below, we have to be careful because some institutions that are taken for granted in some countries, maybe especially in the Anglo-American tradition, are not so easy to establish, let alone to develop, in other latitudes or other cultures.

Institutional design and change are not exclusively economic problems but to the extent that they are economic, they should be addressed with the tools of economics. This is why at the Development Centre we work closely with other departments of the OECD where economic analysis is combined with social science, political science, other types of analysis, and, of course, common sense!

What we want is to influence the way people look at their environment and the way in which they can transform it. The ‘T’ in the TIGER acronym is transformation, so we are not pursuing academic research alone, we are trying to influence governments, especially member countries governments, and we are doing it with a particular set of analytical tools. The way in which development and transition are looked at should not be different in terms of analytical tools, it should be different in terms of the assumptions about institutions, and economists have a lot to say about institutions as well.

There is a saying from a Russian writer, Tolstoy, I think from ‘War and Peace’, that ‘Happy families have the same history but unhappy families are unhappy in their own way’. Developing, emerging and transition countries are very specific. Then you come to accept some rules, maybe OECD type rules, and you find that problems continue difficult but are very similar. Imagine the paradox: poor countries are very different from each other, rich countries end up being more similar on the economic side and yet knowledge about poor countries is far less abundant. You know much less about countries in Central Asia in Latin America in Africa than you do about European countries. You know less about Poland or Portugal than you know about France or Italy or the United Kingdom and yet the problems from an analytical standpoint in Poland, Central Asia or Africa are far more difficult: less data, more different institutions, much more demanding.

This is what we hope to redress through analysis at the Centre and in other parts of the OECD that are concerned with the process of transformation. The OECD is not the rich men's club any more. The Secretary-General constantly reminds us about the importance of development for the OECD. The last time I heard him say this was in Naples two weeks ago at the *Third Global Forum on Fostering Democracy and Development through E-Government*. By the way, if you spell out OECD, 'D' stands for development. We are on a familiar terrain.

Under the general umbrella that the way to understand development, that includes transition as I just said, is to combine two great forces: globalisation and governance (G&G). At the moment, these are at work all over the world. Globalisation is not just about trade but about the opening of other markets, capital markets, information markets and even, to some extent, about migration. We look at the challenge it represents and we look at the responses on the governance side. That is to say what do national, regional such as Europe or even global institutions do, and what can they do to cope with the challenge of globalisation? That is the problem at hand. To address it, I will very quickly identify four topics: digital divide, G&G, institutions and "change as rule" – which will be my conclusion.

Digital divide

The role of the new technologies, (or the "New Economy") in developing countries raises the issue of the "digital divide" discussed, for example, at the Naples conference I just mentioned. It all fits in one acronym, DIALECTTT with three T's: Digital Infrastructure, these are the keys to being able to take advantage of the information technology; Access, Literacy, not just broadly speaking but the computer literacy, and our favourite words at the Development Centre – Entrepreneurship and

Contents, what is it that you are actually transmitting. Then finally the three T's: Trust, Taxes and Transparency, three crucial dimensions of governance, which could almost be lumped into one.

How can you live in a society without trust? You may say that you do it all the time. I understand. But we all know that the importance of trust is there, you may not find it in our day-to-day relations as much as we would like but we, economists, understand how trust is important. Maybe we call it incentive compatibility, it does not matter, but we understand it very well. Taxes – we also understand that when they are too high, they destroy trust. Finally, transparency, which is another way of saying that clean government, public opinion and civic society matter for trust to be sustained. I am sure that you have already heard about the example of procurement of weapons in India. By the way, it is a member of the Development Centre who joined a few weeks ago. In India you saw how new technologies were able to create an atmosphere of transparency that would otherwise not have been possible. Based on this DIALECT (one T might do), we can rule out the scenario of a new economy for all but also the scenario of a widening digital divide. It all depends, you guessed it, on G&G. I now build on this to present two specific points from my research.

<u>Globalisation and Governance (G&G)</u>

One point has to do with finding indicators of governance and indicators of responses to globalisation and then ranking countries in some way. I have done this exercise in joint work with Bill Branson and Jurgen von Hagen (2001), which is applied to Poland, Czech Republic, Hungary and Slovakia, and which has been published in *The World Economy* (Macedo 2000). But in the Appendix I flag research that I have just completed and that goes deeper into the way in which globalisation can improve governance.

By opening up your economy not only do you get the usual benefits that we know about in terms of international trade theory, but in addition you get a premium on good governance. To be very specific, greater import openness has about the same effect as GDP growth in lowering corruption That is a very important result because it shows that, contrary to what you may think or what public opinions or markets may think, good governance is not a privilege of the rich and of the countries that have been rich for quite some time.

This is a result that allows us to counter head-on geographical and historical determinism. If you start looking on a panel with many countries, you find that countries that are Anglo-American and have been richer in the past are more likely to have good quality of institutions, greater openness and so on. You get perplexed because you think that if you happen to be in the middle of Africa or in Central Asia, there would be no hope, maybe if you wait for 300 years. That is not very comforting. It may be more comforting for you guys who are younger, but still we will agree that 300 years is beyond your horizon (Macedo 2001).

Our result shows that, if there are policies of opening up to trade, their effect on governance, an important dimension – the perceived corruption indicator - is comparable to that of the income level. There is something you can do about good governance, there is something you can do about fighting corruption, that is much easier to achieve than hoping that you get the level of income of Belgium. And what is it? – To open up more. Rather than get into the details of the particular regression and the instruments that we have used, I want to leave you with their implications. As a result of the kind of research that we do, which is to apply econometric analysis to problems that worry policymakers the world over and worry public opinion, we can draw some broad policy implications.

Let me stress one more time that the results of the research are very much against geographical or historical determinism. Some say that there is one Europe of the wine and one Europe of the beer, that the Europe of the beer is developed and the Europe of the wine is underdeveloped, and that is just the way it is. Well, according to our results, it is not.

There are many things governments can do to improve governance. One of them is to open up to trade and to capital movements. The result I reported to you is about trade, but we have a similar result about capital movements, even though the coefficient is slightly smaller.

Institutions

As regards institutions and development, I will first mention international institutions, and the OECD in particular. The OECD has a very special role in the international architecture. Even though it deals mostly with economics, it does include some social departments - the Social Directorate is very active. Yet it is the only organisation in the world that does not have a lending or borrowing agenda either implicit or explicit (I elaborate in my 2001). That is important in the world that we can contrast the analysis, we are not questioning the excellence of the research staff in the IMF or in the World Bank, because most of us have drawn a lot on the excellent quality of these institutions, and they have been very active in many areas that I talked about – governance, fighting corruption and so on. The point of the matter is that they have a mandate, which is very operational. You have to solve the problems of the countries that come to the IMF for assistance and you have to solve the development problems of countries of the World Bank and you have to do so in an operational way.

The OECD in this regard is a peer pressure organisation. A member country presents its views and it knows that another country will say: 'By the way, I went through this experience, I had this particular solution, does it work with you? Does it not?' As you said very rightly, with the entry of new members, Mexico, Korea, Poland, other formerly planned economies, the diversity increased and therefore the path of development rather than the state of high development becomes the most important challenge for the OECD. This is why I called it, the Secretary-General was saying, the 'D' has come back because in the 1960s when the OECD was created or even before when it was called the OECE, it was only about Europe, the 'E' was replaced by 'D'. During that time European countries were developing countries, they had been devastated by war. There was a sense of development of moving from one place to the next. Maybe this was lost and now, with the new accession countries, it is back. This is why, as I say, you must look at it not as a rich countries club but rather as a challenge of development. I do want to stress that this is unique in the international order.

How should you redesign this international order? I have a personal answer coming from my experience in Europe, with the European institutions, which has again to do with peer pressure. I find the procedures of surveillance that were adopted by the European Community in connection with union treaty, and this is not because I signed that treaty, it has to do with the profound belief that these procedures can work. It is much more exacting that IMF surveillance because IMF comes at a moment, very often of crises, you have to do things very quickly and very strongly whereas in the case of the European Community it had to do with making countries like Portugal or Italy understand that it was not in their interest to have high deficits. That is a much more profound objective and it requires more profound, more intrusive perhaps, but again more reciprocal types of surveillance which are now visible for example in structural issues, in competition and in very deep issues of national sovereignty. That is peer pressure. That is nowhere to be found in an institution that is lending or borrowing.

The way to redesign institutional order would be to my mind a little bit Euro-centric. It would inspire itself in the model of Europe because countries need greater surveillance on structural areas

(Macedo 2000a). By the way, the IMF is already doing it. It is going more into banking sector reform, it is collaborating with the World Bank on this score. But still the best example of IMF intervention and successful intervention has to do with balance of payments problems, that is what they were born to do. This is why also the World Bank has often been criticised for doing too many things, therefore not being able to do any one sufficiently and effectively. My answer again is that - if you take more inspiration in the willingness of countries to collaborate on a peer pressure basis, then you do better than if you continue with top-down schemes.

That is going to take me to the possible solution to the Seattle and Prague demonstrations. Globalisation has acquired that dimension of excluding rather than including. We have done a lot of work at the Centre on the impact of globalisation on income distribution. It is very different. There are good cases and bad cases but the public image is that globalisation is really increasing inequality; it is creating a society of excluded people. This is why in our program we talk about inclusive globalisation. This perception must be fought; it must be fought with analysis, not with rhetoric. We are collaborating with the research department of the World Bank to investigate some aspects of NGO governance. Why do we want to investigate NGO governance? Because, for example, we know that out of one dollar of aid that leaves the OECD countries maybe only a quarter arrives in the countries in question. What about one dollar of aid from NGOs? We do not know. Here is the case where economic analysis of the traditional kind could be applied and help dispel some myths but still also emphasise some problems that have to be changed for globalisation to indeed lead to improved governance, as the regressions in the Appendix show.

Change is the rule

Now "change is the rule". I am convinced that, in this environment, economists can contribute to understanding institutional change. Jurgen von Hagen pioneered this. He sat down with a lawyer (it is very important not to leave the lawyer alone because otherwise the exercise risks getting out of hand) and they looked at the budget laws of various countries (see von Hagen and Harden 1994 and 1996). He tried to show in what way you could compare the procedures for the budget to be approved and then passed in parliament. Similar work had been done by Cukierman (1992) and others about the central bank or about monetary institutions and, using similar approaches, there is a lot of very detailed work on corruption and on governance (see for example Wei 1999, Macedo 2001).

At the Development Centre, we have indicators of structural reforms, the World Bank does too. This is the kind of work I am talking about. That I think is useful not just for Poland, not just for Mexico, not just for Korea, to mention OECD member countries, but for the entire gamut, including the founding fathers. This is because I think that this stability of the Anglo-American countries is an illusion. The point of the matter is that there is a fair amount of stability but also a fair amount of instability. It turned out to be convenient for economists to put institutions aside and concentrate on the level of income. That these countries have a much higher level of income makes a difference, as Lucas (1998) claimed. This being said, one need not identify rich countries with happy countries, just as one need not identify rich families with happy families.

Appendix

The second stage regression results for import openness for the two samples used by Bonaglia, Braga de Macedo and Bussolo 2001 (depending on the source of the Corruption Perceptions Index adjusted to fall with corruption, where *large* covers yearly observation for 1984-00 in 140 countries and *small* covers 1980-85 average, 1988-92 average and 1995-00 yearly data for 99 countries) can be summarised as follows.

The regressions are in lin-log specification, meaning that the dependent variable, corruption, is in linear format and the independent variables are in logarithmic format. In this specification we can interpret the coefficients as the marginal effect on corruption of a change in the logarithm of the dependent variable, or, as the marginal effect due to a relative (percentage) change in the independent variable in linear format.

The prediction is that a 10% increase in imports openness results in 0.07-point change in the corruption score (0.74 x 0.1) in the larger sample, and in 0.2-point change (2.06 x 0.1) in the smaller one. This is a sizeable effect, especially when compared to the 0.13 and 0.12-point changes due to a 10% increase in log GDP per capita.

Instead of an arbitrary 10% change, it may in fact be more instructive to consider more realistic variations in the dependant variables such as their observed standard deviations. This exercise results in a 0.40 reduction of corruption (0.74 x 0.54) and a 1.11 reduction (2.06 x 0.54) respectively.

To isolate the direct impact of openness on governance we need to consider other important simultaneous determinants of corruption. Controlling for dependence on oil and mineral exports does not change the overall picture. In these specifications a high explicative power is achieved, even if not all the included variables are significant at conventional levels. The basic results concerning openness and corruption are unchanged: the magnitude of import and capital openness is slightly increased and the coefficients remain statistically significant.

Interestingly enough, while dependence on natural resources turns out to be a significant determinant of higher level of corruption, ethnic fractionalisation is never significant, nor has the expected negative sign.

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