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FALL CONFERENCE
ON
POLICY REFORM ISSUES

INSTITUTE FOR POLICY REFORM

Washington, DC

November 29 and 30, 1990



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*1400 16th Street NW
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SUMMARY

The Fall Conference of the Institute for Policy Reform (IPR) had the joint objectives of acquainting USAID professionals with the Institute, Fellows and staff, and developing a common understanding of USAID perceptions of policy reform issues and related research and educational priorities. The Fellows of IPR are defining research projects that will reflect the conference consensus on issues and priorities. These themes will also be used in defining the educational and research programs of centers that will be organized in affiliation with the IPR and in organizing an International Development Consortium that will insure broad participation by development professionals in IPR programs.

Reginald Brown, Assistant Administrator, Bureau for Program and Policy Coordination, opened the conference with a provisional list of six issues:

- . How should governments reduce protection?
- . How should market reforms be implemented?
- . How should market reforms be sequenced?
- . What are appropriate policies for easing burdens of reforms on the poor?
- . What policies can stimulate economic growth without damaging the environment?
- . What are the linkages between macroeconomic, trade, and environmental policy?

The discussion in the concurrent and plenary sessions involved these six themes as they are reflected in country and region-specific contexts, and the implicit harmony of political and economic organization that seems to accompany successful and sustainable policy change. USAID professionals emphasized the importance of local circumstances in timing of decisions on policy reform and policy reform dialogue, and the necessity of coordination among donors and leveraging as a key to high impact policy change initiatives.

Packaging of policy reform measures was emphasized as important to success and sustainability. Examples include macro and monetary policy settings for trade and pricing policy adjustments, safety net policies and privatization measures that may require labor force adjustments, public finance and taxation structures that can insure appropriate government services, sequencing and staging as elements of reform packages. There is also a growing interest in designing evaluation systems that can measure the success of reform initiatives and help in the overall USAID policy reform programming process.

Specific recommendations for research and education initiatives in which USAID and IPR could effectively cooperate included:

- . Privatization processes, competition policy, and institutional requirements for successful transition.
- . Formal and informal financial markets and their role in transitional processes.
- . Political structure and democracy as elements of economic policy reform.
- . High and low policy as reform agendas, improved efficiency and immediate impacts versus institution and informal structure support.
- . Finance of government, taxation incentives and administrative feasibility.
- . Corruption, the informal sector and changes to make government a more constructive force in policy reform.
- . Trade policy, strategic domestic development policy and foreign ownership and control.
- . Technology and research and development compared to policy reform as engines of growth.

IPR representatives emphasized a willingness to cooperate in addressing the policy reform agenda, but cautioned that more solid foundations for the reform initiatives are the ultimate key to a development assistance strategy that can effectively support transitional economics.



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P R O G R A M

Objective: To provide a forum for productive exchange on policy reform issues between IPR Fellows and Board and AID development professionals from Washington and the missions.

Format: An opening plenary session will include a broad discussion of the IPR program and reflections of senior AID administrators on policy reform issues.

A workshop format will encourage informal dialogue to identify and prioritize policy reform concerns by region, and to focus and refine the research agenda of IPR. Two regional workshops will be held concurrently; the program will be repeated to allow participants to attend all four regional discussions. Each workshop will be co-chaired by a senior official of the Bureau and an IPR Board member.

The closing plenary session will focus on summations of the workshops.



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Thursday, November 29, 1990

9:00 a.m. - 10:30 a.m. Opening remarks

Reginald J. Brown, Assistant Administrator,
Bureau for Program and Policy Coordination

Review of IPR existing and planned programs
Stanley R. Johnson, IPR Board

Overview of IPR Senior Research Fellow projects
Gordon Rausser, IPR Board

Related USAID policy change initiatives:

- . John Blackton, Deputy Assistant Administrator,
Bureau for Program and Policy Coordination
- . John Sullivan, Director, Washington Office,
International Center for Economic Growth (ICEG)
- . Catherine Gordon, General Business Specialist,
Bureau for Asia and Private Enterprise
- . Mancur Olson, Principal Investigator, Institutional
Reform and the Informal Sector (IRIS)

Moderator: Stanley R. Johnson

10:30 a.m. - 11:00 a.m. Coffee Break

11:00 a.m. - 12:00 noon Reflections of USAID senior administrators:

- . George Laudato, Deputy Assistant Administrator,
Bureau for Asia and Private Enterprise
- . Larry Sayers, Deputy Assistant Administrator
Bureau for Africa
- . Bastiaan Schouten, Director, Office of Development
Planning and Programs, Bureau for Latin America
and the Caribbean

Moderator: Arnold Harberger, IPR Advisory Board

12:00 noon - 1:00 p.m. General Discussion

1:00 p.m. - 2:30 p.m. Buffet lunch for all participants



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2:45 p.m. - 3:45 p.m. Concurrent regional workshops:

Policy Reform Concerns in Africa

Co-chairs: Jerry Wolgin, Chief Economist,
Bureau for Africa
Yair Mundlak, IPR Advisory Board

Policy Reform Concerns in Latin America

Co-chairs: James Fox, Chief Economist, Bureau for
Latin America and the Caribbean
Arnold Harberger, IPR Advisory Board

3:45 p.m. - 4:00 p.m. Coffee Break

4:00 p.m. - 5:00 p.m. Concurrent regional workshops:

Policy Reform Concerns in Eastern Europe

Co-chairs: Paul O'Farrell, Chief Economist, Bureau for
Europe and the Near East
Mancur Olson, IPR Advisory Board

Policy Reform Concerns in Asia

Co-chairs: Michael Crosswell, Senior Economist, Bureau
for Asia and Private Enterprise
Ronald McKinnon, IPR Advisory Board

5:30 p.m. - 7:00 p.m. Reception

7:00 p.m. - 9:00 p.m. Dinner



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Friday, November 30

- 10:00 a.m. - 11:15 a.m. Concurrent regional workshops:
- Policy Reform Concerns in Eastern Europe
- Co-chairs: Paul O'Farrell, Chief Economist, Bureau for
Europe and the Near East
Mancur Olson, IPR Advisory Board
- Policy Reform Concerns in Latin America
- Co-chairs: James Fox, Chief Economist, Bureau for
Latin America and the Caribbean
Arnold Harberger, IPR Advisory Board
- 11:15 a.m. - 11:30 a.m. Coffee Break
- 11:30 a.m. - 12:45 p.m. Concurrent regional workshops
- Policy Reform Concerns in Africa
- Co-chairs: Jerry Wolgin, Chief Economist, Bureau for
Africa
Yair Mundlak, IPR Advisory Board
- Policy Reform Concerns in Asia
- Co-chairs: Michael Crosswell, Senior Economist, Bureau
for Asia and Private Enterprise
Ronald McKinnon, IPR Advisory Board
- 1:00 p.m. - 2:00 p.m. Buffet lunch for all participants
- 2:00 p.m. - 4:00 p.m. Summation of workshop discussions by co-chairs
- Moderator: Vernon Ruttan, IPR Advisory Board
- Summation of conference
Stanley R. Johnson and Gordon Rausser



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Arnold C. Harberger, Chair, UCLA and University of Chicago
Ronald McKinnon, Stanford University
Yair Mundlak, University of Chicago
Mancur Olson, University of Maryland
Vernon Ruttan, University of Minnesota

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George Akerlof, University of California, Berkeley
Sebastian Edwards, University of California, Los Angeles
David Newbery, University of Cambridge
Todd Sandler, Iowa State University
T. Paul Schultz, Yale University
Joseph E. Stiglitz, Stanford University
Erik Thorbecke, Cornell University
Robert M. Townsend, University of Chicago

Prospective Senior Research Fellows:

Glenn Loury, Harvard University
Richard Just, University of Maryland
Charles Plott, California Institute of Technology
Nicholas Stern, London School of Economics
Nancy Stokey, University of Chicago
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Donald Sillers
Michael Unger
Robert Young

Bureau for Europe and Near East:

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Bastian Schouten
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Vernita Fort
James Fox
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Bureau for Food for Peace and Voluntary Assistance:

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Stuart Callison

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William DeWald, Bureau of Economics and Business
Robert Dohner, Bureau of Economics and Business
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Ken Kauffman, Bureau of Intelligence and Research

Institutional Reform and the Informal Sector

Mancur Olson
Christopher Clague

International Center for Economic Growth

John Sullivan

Michael Pillsbury
Staff, Senate Subcommittee on International
Economics Policy

Conference Synopsis

On Thursday and Friday, November 29 and 30, 1990, sixty four professionals from the United States Agency for International Development (USAID) and twenty eight representatives from the Institute for Policy Reform (IPR) met in Washington, DC, for IPR's 1990 fall conference on policy reform issues. The objective of the conference was to provide a forum for productive exchange on policy reform issues between IPR fellows and board and AID development professionals. As the conference developed the objectives became more clearly articulated as:

- To acquaint those not yet familiar with the Institute for Policy Reform with the senior fellows and the organization of the Institute
- To receive suggestions and guidance, and to deepen the common understanding of policy reform issues, priorities, and emphasis that USAID is giving to policy reform. What are the issues? What are the important common themes? What has been the experience with policy reform in development assistance? How can we evaluate and learn from this experience?

Opening Session

Reggie Brown, assistant administrator, Bureau for Program and Policy Coordination, opened the conference by challenging the IPR to provide USAID with a direct channel to a rapidly expanding university research base on policy reform issues and show how research results translated from the frontiers of theory can be put into practical applications and improve USAID's ability to design, implement, and evaluate policy reform. Brown suggested that the new USAID mission statement provides a framework for setting the general research agenda for the IPR. This statement lists six issues to resolve as economies evolve from command and control systems to rely more on open markets, individual incentive, and competition:

- How should governments reduce protection for some industries?
- How should market reforms be implemented?
- How should reforms be sequenced?
- What distributional policies should be adopted to ease the burden on the poor?
- What are the governmental policies that contribute to economic growth without damaging or altering the nature of the environment?
- What are the linkages between macroeconomic policy and trade policy and the environment?

In developing and implementing assistance programs, he said, USAID is guided by six principals:

- Support for free markets and broad based economic growth
- Concern for individuals and the development of their economic and social well-being
- Support for democracy
- Responsible environmental policies and prudent management of natural resources
- Support for solutions to lasting transnational policies
- Humanitarian assistance to those who suffer from natural or man-made disasters

To conclude his remarks, Brown observed that "a fuller appreciation of USAID's mission should help IPR focus its agenda on real-world development problems."

Stan Johnson, chair of the IPR board, summarized the current plan for the Institute by reviewing its four major components: the advisory board, the senior research fellows program, the university centers, and the international development consortium. The advisory board provides

guidance and counsel from professionals with long experience in development assistance and with wide ranging interests and accomplishments in economics and policymaking. The senior research fellows program forms the intellectual heart of the IPR. According to Johnson, "If this institute is going to make a substantive contribution to development assistance and the capacity to deal with policy reform problems, we are going to have to push back the boundaries of the policy sciences." The university centers program will develop centers at major U.S. universities that will carry out educational, research, and training programs emphasizing policy reform. The function of the international development consortium will be to facilitate communication necessary to focus the research activities of IPR and to insure that the results developed flow into the policy reform arena.

Johnson also summarized the activities of the Institute to date. A USAID cooperative agreement was effected in fiscal year 1990 to initiate the Institute, with funding at one million dollars per year for five years. The first-year funding was assigned to the Center for Agricultural and Rural Development (CARD), at Iowa State University, to establish IPR. The cooperative agreement will revert to IPR in the spring of 1991. The board of directors has been elected, the by-laws drawn, and the articles of incorporation filed with the District of Columbia. Offices have been leased and equipped, and IPR is fully operational in Washington, DC. The advisory board has been appointed and fourteen of twenty senior research fellows have research projects underway. The one million per year core funding will be used to operate the Washington offices, support the fellows programs, operate the advisory board, hold conferences similar to this one, and plan the university centers and international development consortium.

Gordon Raussler, president of IPR, began his remarks by asking, rhetorically, why is there such great emphasis on policy reform as a theme in development assistance? His answer: there is increasing recognition that sustained economic growth is intimately tied to a policy setting that involves markets and broad participation in governments that pursue public good investments.

A real opportunity exists, he said, for putting two groups together where the whole will be much larger than the sum of the parts: development professionals with specialized knowledge of national institutions, economies, and governments, and world-class researchers committed to improving the foundations for policy reform.

Raussler continued by emphasizing that many of the prescriptions from traditional economics have not worked. Historically, bad governments have been a serious obstacle to achieving broad-based economic growth. While all public sectors pursue a mix of predatory and productive policies bad governments have a way of emphasizing the former and good governments find a way of promoting the latter. Empirical studies suggest that policies which encourage competitive forces are a key to attaining sustainable growth; institutions play a key role in creating and maintaining growth oriented policies; and policies and programs must be balanced. The IPR through an aggressive research and education program, will support development assistance initiatives and will be in a position to directly advise and counsel governments on how to go about setting the "rules of the game" to encourage and foster economic growth. Raussler stressed three major forces which lead to significant reform:

- Major change in the economic environment (Indonesia 1981, Bolivia 1985)
- Creative new design in the implementation of policy mixes and/or compensation schemes (North Korea, Taiwan, Japan)
- Emergence of new political factions or major institutional changes (New Zealand, Eastern Europe and Soviet Union)

The IPR must be in position to provide a basis for capitalizing on the opportunities that are presented by these three forces, as well as others that can open the door to changes in policies that can stimulate

sustained economic growth.

Three challenges to achieving these objectives are

- The economic profession itself
- Limited programs in USAID for augmenting the human capital of USAID development professionals on policy problems
- Merging the USAID perspective on policy problems, a problem-rich perspective, and the professional economic perspective, a solution-rich perspective

In combining a problem perspective with a solution perspective, enriched by the IPR programs, the hope is that real progress can be made. The conceptual leaders in the economics profession will be exposed to a new, and perhaps improved specifications of the real problems and the practitioners will be able to use the concepts that evolve in a more effective way.

Rausser then commented on the projects of the senior research fellows project:

- George Akerlof, professor of economics, University of California at Berkeley, is examining the impacts of irrationality on possibilities for policy change: large start-up costs, myopia, leadership and procrastination limit possibilities for effective reform. An application of these concepts and a new organizing framework will be made to the unification of East and West Germany.
- Sebastian Edwards, Henry Ford II Professor of International Business Economics, Anderson Graduate School of Management, University of California at Los Angeles, is addressing the dynamics of reform: the sequencing of reform measures and the optimal speed or the pace of policy reform.
- Stan Fischer, professor of economics at the Massachusetts Institute of Technology and a research associate of the National Bureau of Economic Research, is examining the transition process in socialist economies, financial and price reforms, and the introduction of new markets, with implications to be drawn from case studies of Hong Kong, Japan, Korea and Taiwan.
- Anne Krueger, Arts and Sciences Professor of Economics at Duke University and a research associate of the National Bureau of Economic Research, is emphasizing the political economy of policy reform and analyzing the role of governments versus markets in effecting reform and in conditioning sustainability.
- David Newberry, professor of applied economics, Cambridge University and, director of the Department of Applied Economics, is investigating privatization with a focus on the possible problems that can occur when property rights are established without an appropriate legal structure. He will also evaluate the multiplicative impacts of multiple distortions.
- Todd Sandler, professor of economics and political science at Iowa State University, is examining public good investment strategies and infrastructure; the design of incentive schemes and institutional arrangements that can foster rational collective choices and blend effectively with market economies.
- T. Paul Schultz, Malcolm K. Brachman Professor of Economics and Demography and director of the Economic Growth Center at Yale University, is evaluating social welfare programs, particularly family planning, health and education, and the selection of institutional designs for effective delivery systems: public sector versus private nonprofit organizations.
- Joe Stiglitz, professor of economics at Stanford University, senior fellow at the Hoover Institution, and research associate at the National Bureau of Economic Research, is applying the results of his past work on the role of information, moral hazard, principal-agent, and adverse selection to agricultural capital markets, their organization, and formal and informal sector participation.
- Eric Thorbecke, H.E. Babcock Professor of Economics and Food Economics at Cornell University, is examining the impacts on income distribution and unemployment, with particular

emphasis on the most vulnerable socio-economic groups; all based on alternative paths of reform initiatives.

•Rob Townsend, professor of economics at the University of Chicago and a member of the population and the economics research centers at the National Opinion Research Center, is evaluating the many risk reduction proposals that may have negative effects (family size and deforestation) if they fail to appropriately reflect the private institutions that have emerged to handle risk and insurance.

•Oliver Williamson, Transamerica Professor of Business, Economics and Law, University of California at Berkeley, is focusing on incentive alignments in new institutional structures and their role in improving efficiency and limiting counterproductive activity.

Discussions are under way on research proposals with a number of prospective senior research fellows: Glenn Loury, Harvard University; Richard Just, University of Maryland; Charles Plott, California Institute of Technology; Nicholas Stern, London School of Economics; Nancy Stokey, University of Chicago; and Jean Tirole, Massachusetts Institute of Technology.

Finally, Rausser summarized a research project being undertaken by the IPR staff. A team including Johnson, IPR staff economist John Mc Millan, IPR coordinator Robert Murdock, Rausser and others, will develop a cross-sectional, time-series data base to analyze the interaction of economic resources, economic policies, and the underlying institutions and constitutions. An innovation of this project is to quantify institutional and other variables which have been associated historically with sustained economic growth.

John Sullivan, director, Washington Office, International Center for Economic Growth (ICEG) reviewed the structure of ICEG and the projects it is initiating. He stressed that "local ownership" is important in reforming policies; in order to generate policy change, it is necessary to have a feeling that the ideas are being generated within the country. Getting results out and disseminating information is an important activity of ICEG.

Catherine Gordon, general business specialist, Bureau for Asia and Private Enterprise, summarized USAID programs and projects in the area of policy reform, with four observations:

•USAID has an incredible variety of policy reform projects already in existence, including separate policy reform initiatives in: privatization, the financial sector, institutional reform, democratic initiatives, women, housing, trade and investment, interregional relations, macroeconomic fiscal and monetary areas and health.

•USAID employees generally recognize that in one way or another they are in the policy reform business.

•There is agreement, at all levels of the agency, that policy reform is essential to a successful development strategy. This represents a change from the past USAID orientation towards the village level to the view that U.S. intervention is, in a larger context, most appropriate at the policy level.

•A consensus exists at USAID about policy reform: a general belief in broad-based economic growth and political pluralism. Economic and political rights are the foundations on which dynamic and thriving economies are built.

Mancur Olson, principal investigator, Institutional Reform and the Informal Sector (IRIS), and member of the IPR advisory board, reviewed the foundations for the IRIS project. IRIS has affiliated with the IPR in order to coordinate and leverage the resources and research and educational programs on policy reform. The project is funded by a cooperative agreement between USAID and the

University of Maryland. Its focus is research on institutional reform, technical assistance, and education in developing countries and Eastern Europe that leads to institutional reform and improvements in the performance of the economies of these countries. Olson's example of the incentives of a dictator with respect to property rights of his subjects illustrated the challenge and importance of institutional reform. With a long time horizon, a dictator might gain in tax revenues from respecting the rights of subjects, whereas with a shorter time horizon, the dictator's interests might be best served by appropriating the property of the subjects. This uncertainty, combined with the lack of mechanisms for orderly transitions between dictatorships, clouds the security of property in dictatorships, limits participation in economic decisions, and distorts incentives.

Reflections of Senior USAID Administrators

John Blackton, deputy assistant administrator, Bureau for Program and Policy Coordination noted that the drift of USAID away from economics over the past fifteen years started with the onset of the basic human needs approach to development assistance. This approach mandated that USAID operate at the individual, or grass-roots, level. However, in the late 1970s and early 1980s, USAID learned that programs directed at the micro level mattered little if the overall policy setting was wrong. The remainder of Blackton's remarks were organized around four topics:

- The economic dialogue process
- USAID's democracy initiative
- The environment and natural resources
- The evaluation of policy oriented programming.

Findings from policy dialogue in Africa over the past few years, Blackton said, indicate that

- Removing price and market controls typically has a positive impact on economic growth, but the private sector in developing countries is often hesitant to take full advantage of new market opportunities, perhaps due to lack of confidence in permanence of reforms.

- Eliminating governmental subsidies and restrictive industrial regulations reduces pressures on public sector budgets, but doing so also forces painful adjustments on some producers, who often successfully appeal the reforms in the political arena.

- Streamlining and moderating tariff structures improves efficiency, but these improvements in efficiency are not always matched by reductions in nontariff barriers.

- Eliminating monopolies of state-owned or authorized enterprises allows private business firms to compete and thereby improve economic efficiency, but the interlinkage to markets where governments continue to exercise monopoly power undercuts the new competitive forces.

The democracy initiative at USAID is a result of the administration's support for democratic institutions, which has moved to the center stage of the Bush-Baker foreign policy. USAID now takes as given that open societies which value individual rights will, over time, provide better opportunities for sustained economic development. While there is evidence that it is possible to have economic reform without democratic reform and achieve growth -- or to have the reverse and achieve growth, ultimately, either one without the other runs into barriers. Over time, a liberal economic framework without democracy cannot be reconciled with the competing demands in society.

For the environment and natural resources policy, USAID has had a decade of scientific involvement, but little policy experience in relating the environment to overall economic policy and policy related development assistance. There are numerous possibilities for unintended and

destructive distortions which may emerge if environmental and growth policy problems are solved in isolation.

Finally, Blackton noted that the agency is involved in its first major look since 1961 at overhauling its evaluation system. In addition to issues on evaluation in general, there is the special question of how to evaluate projects and programs which have as their primary objectives changes in economic policy and political institutions.

Larry Sayers, deputy assistant administrator, Bureau for Africa, emphasized that African countries have reputations as real reformers. The African bureau has made significant budget allocations to support nations that have changed economic policies and improved performance. Since the United States is not a major player, among donor nations, in Africa, available resources are programmed to go where the action is, and large field staffs are used as leverage with other donors to achieve coordination and focus on policy reform.

Sayers said that major policy problems in Africa are export promotion, revenue generation, and privatization. Export promotion is a policy objective of many emerging African nations. Since many African economies are not market economies, the establishment of free trade regimes may not necessarily be the best short-term policy response. Typically, the World Bank and USAID push for reductions in tariff rates and income or corporate profit tax rates, while the IMF pushes for higher tax rates to meet debt obligations. This is a source of continuing inconsistency in the policy reform advice that African nations are receiving. The push for privatization has wrongly been independent of a recognition of an associated need for a regulatory environment that can harness the forces of competition.

Outcome problems for policy reform in Africa include low growth rates, debt problems and the social costs of adjustment. Growth rates have been slightly above population growth rates, but per capita growth of four or five dollars per year will not improve African living standards for a very long time. How can African countries attain the growth rates that have characterized the Pacific Rim countries? Is it more sensible to make the debt bill the residual in lean years rather than the driver of economic policy and investment strategies? Finally, social costs of policy adjustments may be a red herring, since USAID evidence does not find large costs being born by segments of the population that are normally thought to be at risk in periods of economic adjustment.

Bastiaan Schouten, director, Office of Development Planning and Programs, Bureau for Latin America, addressed three intellectual issues that still challenge the proposition that policy reform is good as a centerpiece of development assistance. Free trade allows regulators fewer degrees of freedom for control, and the impact of free trade on the environment is not yet known. Another issue is the impact of structural reform on the poor. Evidence from Costa Rica suggests that lower income salaried workers have done better, relative to other members of the population, after the reform process. Finally, there is a need to better document the benefits of economic growth and related policy initiatives for women.

George Laudato, deputy assistant administrator, Bureau for Asia and Private Enterprise, observed that economic performance in Asia during the 1980s was good. Economic growth rates in South Asian countries were greater in the eighties than in earlier periods, while East Asian countries experienced slowdowns in growth in the early eighties, followed by a recovery in the later eighties. Generally, economic performance in Asia has resulted in declines in the incidences of poverty. What

can be learned from the Asian experience about the successful types of policy reforms and how they should be implemented? There has not been much thorough study of the Asian experience of the 1970s and 1980s as influenced by development assistance activities.

A general discussion followed these opening statements. Nick Stern emphasized that the evidence is not in on the side of superior economic performance of democracies, giving Korea, Singapore, and other Asian nations as examples. Mancur Olson related his research results that the variance of growth rates for dictatorships was greater than that for democracies. Sebastian Edwards stressed the importance of recent developments in the new political economy, and noted that experiments with independent central banks are examples of new institutions for developing economies. Ron McKinnon asked what types of institutions counter predatory governments; what is the evidence of the balance of these institutions between predatory and productive economic activity? Martin Bailey asked why it is in the interest of the United States that developing countries grow faster, stressing that altruism is not the only motive for development assistance efforts. Vernon Ruttan emphasized that in U.S. development assistance policy, strategic objectives always have won over development objectives when the two have collided. Robert Townsend noted that we tend to erroneously use policy reform and institutional reform interchangeably. A more careful approach is needed in developing a basis for interventions aimed at both institutions and policy. Successful reforms likely involve a package with both institutional and policy measures.

Summation of Workshop Discussions

The conference then met in smaller groups to discuss regional issues. Jerry Wolgin, chief economist, Bureau for Africa and Yair Mundlak, Frederick H. Prince Professor of Economics at the University of Chicago and member of the IPR advisory board lead the discussion in the Africa session. James Fox, chief economist, Bureau for Latin America and the Caribbean and Arnold Harberger, professor of economics, University of California at Los Angeles, the Gustavus F. and Ann M. Swift Distinguished Service Professor, Department of Economics at the University of Chicago and chair of the IPR advisory board lead the discussion in the Latin America workshop. Paul O'Farrell, chief economist, Bureau for Europe and Near East and Mancur Olson, distinguished professor of economics and the director of the center for Institutional Reform and the Informal Sector (IRIS) at the University of Maryland and member of the IPR advisory board lead the discussion in the Eastern European workshop. Michael Crosswell, senior economist, Bureau for Asia and Private Enterprise and Ronald McKinnon, William D. Eberle Professor of International Economics at Stanford University and member of the IPR advisory board lead the discussion in the Asia workshop.

Summarizing the discussion in the Latin America workshop, Fox emphasized that the region is at a watershed: that all alternatives to sound economic policy seemingly have been proven unsustainable, and that no government in Latin America is uninterested in moving toward freer markets, the question is how this move should be made. This watershed provides an unusual opportunity to economists and for systematic policy reform. Harberger then summarized the topics discussed in the concurrent sessions on Latin America:

- Developing criteria for judging when government entities are simply too big and obstructive in the policy reform process
- Regulating privatized former government monopolies and competitive policy
- Measuring externalities associated with infrastructure as a basis for designing public investment strategies

Harberger expressed a hope that as the collaboration between USAID and IPR evolves, there will be a mixing of the academics and field professionals, possibly involving academics visiting the field, as a basis for more productive working relationships. Academics are ready to be more influenced by real problems in their research programs. The IPR is a leading institution in organizing and stimulating this new wave of economic interest and activity.

In his summary of the Asia workshop, Crosswell distinguished between "high policy" and "low policy": high policy is directed at sources of inefficiency, while low policy deals with the more durable sources of growth. This distinction is important, since Asia is now mainly in the low-policy area. Policy reform for Asia thus needs to be interpreted as a long-run process. Five policy areas that are topical in Asian missions are:

- Trade issues: what to make of the Korean experience and managed trade and strategic intervention in trade
- Infrastructure as a local public finance problem, financial responsibilities for improved infrastructure
- Technology transfer, technological change, and intellectual property rights
- Privatization and more deliberate analytical approaches for the process, focusing on the costs and benefits of privatization
- Financial markets: Requirements for better understanding the workings of informal financial markets and the links between informal and formal financial markets

McKinnon emphasized that the study of Asian economies is pleasant, since policy reform has had a visible payoff. There is a real need for USAID and IPR to understand the Asian success stories and to understand what about this experience is transferable or not transferable to other economies and regions. Research into informal credit markets would seem to offer the greatest payoff for other parts of the world.

O'Farrell pointed out that all countries in Eastern Europe are involved in comprehensive economic reform, including stabilization and restructuring efforts. Issues important in this transition include:

- Whether a sudden, "cold turkey" reform or a gradual transition to reform is better.
Joe Stiglitz told the story of two Polish officials discussing reform: one wanted to go cold turkey and have the process over in five years, whereas the other wanted to go more gradually, and have the process over in five years. This illustrates that these terms do not have precise empirical meaning
- The sequencing of reforms, regardless of the speed of transition, is an important issue
- Public finance and systems of taxation are areas where research might help direct reforms in Eastern Europe.

Olson noted that his argument in favor of the cold turkey approach to reform was made even though no society built a set of institutions for a market economy until just three centuries ago. Still, unless the transition is rapid, it is unlikely to happen.

Wolgin emphasized that in the African bureau, practitioners of reform had learned from their practice the issues and information requirements of reform and needed to translate these to the technology developers of reform. Mundlak urged researchers to be honest about facts and to worry not about whether the facts fit a theory, but whether theories fit the facts. Facts which characterize Africa are dysfunctional governments and wrong policies:

- In the policy area, Africa needs to learn how the successes of Asia may be disentangled from the cultures of Asia
- Researchers on Africa should determine what kind of development assistance generates sustainable growth, and which types of aid do not
- A goal of aid should be to generate growth which remains when aid is removed and institutional change fulfills this criteria
- Developing economies have a better potential for rates of growth than mature economies, since expenditures need be made only on imitating knowledge, and not on generating knowledge.

Wrap Up

Observations by Rausser and by Johnson closed the conference. Rausser noted that the economics profession is not yet ready to write the definitive book on policy reform. Rausser emphasized that distinctions must be drawn between nations which are in apparent political equilibrium (Egypt) and those in political disequilibrium (Eastern Europe) when developing approaches for policy and institutional reform, since the types of reform measures appropriate for one may not be appropriate for the other. As a topic for research, the Bush administration proposal on environment/debt swaps offers a number of interesting topics. Johnson confessed that he was startled by the USAID resources that are aimed at policy change (50 percent of the USAID budget in Africa), and that this resource commitment by USAID provides a challenge to the economics profession.

We simply have to deliver on policy reform, observed Johnson. The 1990s are the time when the policy sciences will be looked to for the lead in development assistance. The IPR is a natural response to this challenge and we are pleased that USAID has recognized the challenge and given us an opportunity to create an institution that can directly support the development assistance strategies based on policy reform. We look forward to working with USAID and other development professionals in contributing to more successful and sustainable development assistance efforts. With IPR we have started by engaging the best of the economics profession in developing an improved basis for policy reform. We look forward to working with USAID in fully developing the IPR programs, the university centers for improved research and training programs, and the international development consortium for expanded involvement and participation in focusing and guiding the new policy reform initiatives and for spreading the understanding of the theory and practice of successful interventions to achieve sustainable policy reforms.

INSTITUTE FOR POLICY REFORM

Introduction

Development initiatives increasingly emphasize the importance of policy reform as a key to broad-based economic growth. But professionals responsible for affecting reform lack a sound conceptual framework for use in negotiations on the design of potential policies, and in planning and implementing efficient transition processes. To overcome these limitations, USAID has made a grant to initiate an Institute for Policy Reform (IPR). The IPR will be responsible for organizing and developing the research base and training activities necessary to fully utilize current and newly formulated concepts from the policy disciplines in achieving changes that stimulate and sustain economic growth.

The Institute for Policy Reform will provide developed and developing nations with access to talented and experienced researchers in economics, political science, and the other policy disciplines. Through the IPR Senior Research Fellows and University Centers Programs, preeminent scholars and considerable resources will be focused on policy reform issues important in the development of successful strategies and assistance programs. An International Development Consortium (IDC) operated by the IPR will organize and conduct innovative educational, training, and communication programs for supporting policy reform initiatives.

The specific objectives are:

- to sharpen and elaborate the research results on processes for achieving policy reform;
- to identify and support institutional changes that will promote sustained policy change and orderly and efficient reforms;
- to directly relate available research results on reform to development assistance policy;
- and to support the training, educational, and communication functions of the International Development Consortium.

Organization

The IPR is guided by an Advisory Board composed of experienced scholars and development professionals. Contractual relations with the Senior Research Fellows and a number of University Centers will support the research and educational objectives of the IPR. The International Development Consortium will be operated by the IPR and serve as a link with those directly involved in policy reform processes.

A USAID cooperative agreement with IPR for one million dollars per year for five years to initiate the Institute was effected in fiscal year 1990. The first year funding was assigned to the Center for Agricultural and Rural Development (CARD), at Iowa State University, to establish IPR. The cooperative agreement will revert to IPR in the Spring of 1991. The Board of Directors has been elected,

the By-Laws drawn, and the Articles of Incorporation filed with the District of Columbia. Offices have been leased and equipped, and IPR is fully operational in Washington, D.C. The Advisory Board has been appointed and 14 of 20 Senior Research Fellows have research projects underway. The one million per year core funding will be used to operate the Washington office, support the Fellows program, hold conferences, and plan the University Centers and the International Development Consortium.

The Institute for Policy Reform stands as a non-partisan, not-for-profit organization. Its offices are located at 1400 16th Street, N.W., Washington, D.C. 20036. The IPR program is currently supported by three professional staff: the Administrator, an Economist and a Coordinator.

Program

Advisory Board. The Institute has an Advisory Board made up of experienced scientists and professionals from disciplines relating to policy reform. These disciplines and areas include international economics, institutional economics, development economics, agricultural economics, and political science and economy. The responsibilities of the Board include advising Institute staff on the direction of research and educational activities, and on the strategic positioning of the Institute to insure its resources are best utilized. Membership terms of the Board are for one year and renewable. The members are:

Martin Bailey, Emory University
Bela Balassa, Johns Hopkins University
Stephen Malcolm Gillis, Duke University
Arnold C. Harberger, Chair, UCLA and University of Chicago
Yujiro Hayami, Aoyama Gakuin University, Tokyo
Ronald McKinnon, Stanford University
Yair Mundlak, University of Chicago
Mancur Olson, University of Maryland
Vernon Ruttan, University of Minnesota
Hernando de Soto, President, Instituto Libertad y Democracia, Lima
Alan A. Walters, Johns Hopkins University
and Putnam, Hayes & Bartlett, Inc.

Senior Research Fellows. The Senior Research Fellows affiliated with the Institute are leading scholars in the policy disciplines and experienced professionals interested in policy formulation and the institutions governing policy in developed and developing nations. The fellows develop research programs specialized to policy reform and implementation processes. The Institute also will directly support USAID and other donor agency policy research programs by organizing the participation and involvement of the Senior Research Fellows. On a mutually agreed basis Fellows may serve short-term assignments to assist with policy reform initiatives. The Fellows are appointed by renewable annual contracts. They actively participate in the activities of the IPR and the IDC. They will commit to innovative research programs, and make time available for participation in meetings, workshops, symposia, and other activities of the IPR and the IDC.

Senior Research Fellows appointed to date, and their research projects, are:

George A. Akerlof, University of California, Berkeley:
"Dominant Incentives for the Pursuit of Public versus Private Interests"

Sebastian Edwards, University of California, Los Angeles:
"The Sequencing of Policy Reform Processes"

Stanley Fischer, Massachusetts Institute of Technology:
"Socialist Economic Reform, and Developing Country Industrial and Trade Policy"

Bengt Holmstrom, Yale School of Organization and Management:
"The Financing and Organization of Enterprise"

Anne Krueger, Duke University:
"Political Economy of Policy Reform"

David M.G. Newbery, University of Cambridge:
"The Economics and the Design of Privatization"

Todd Sandler, Iowa State University:
"Public Goods Investments and Infrastructure"

T. Paul Schultz, Yale University:
"Social Welfare Programs and their Institutional Delivery Systems"

Nicholas Stern, London School of Economics:
"Public Finance and Policy Reform"

Joseph E. Stiglitz, Stanford University:
"Imperfections in Financial Markets in LDCs"

Erik Thorbecke, Cornell University:
"Impacts of Adjustment and Reform on Growth, Income Distribution and Poverty, and the Operation of Markets"

Jean Tirole, Massachusetts Institute of Technology:
"Incentives and Processes: Applications to Privatization and Corruption"

Robert M. Townsend, University of Chicago:
"Risk Spreading and Risk Sharing Institutions"

Oliver E. Williamson, University of California, Berkeley:
"Incentive Alignments and New Institutional Structures"

University Centers. The Institute will also coordinate the activities of a number of University Centers. The affiliated University Centers will insure access to the educational and research capacities at major academic institutions. These Centers will be centrally involved in the training and educational programs of the International Development Consortium. The linkage of the University Centers with the Institute will accord the commitment and continuity necessary for the efficient operation of the training, educational, and communication programs of the IDC and for the effective usage of the policy research results developed by the Senior Research Fellows. Universities which have expressed interest in this program to date are the University of Maryland, Duke University, Yale University, Cornell University,

the University of Chicago, Iowa State University, Stanford University, and the University of California at Berkeley.

The International Development Consortium (IDC) will be organized to reflect the special features of development assistance policy in different regions of the world, emphasizing that reforms and processes for achieving reform will differ among nations. The specific objectives are:

- . to establish and institutionalize systematic approaches for policy reform;
- . to carry out training, education, and communication activities necessary to focus broad attention on the value of overall policy reform for sustained growth and development;
- . to provide a framework for effectively coordinating the new USAID policy reform initiative with related activities of other development agencies, donor organizations, and host countries.

The IDC will have a broad based membership, including the Senior Research Fellows, donor agency staff, and other academics and professionals working in the development area. The IDC will operate four programs:

- the Instruction Program, providing short-term and specialized training for those involved in the design and implementation of policy reform;
- the Communication Program, providing the major outlet for the research of the Institute and distributing the materials and results from activities of the Consortium;
- the Conference Program, assisting in establishing the network necessary to guide policy reform research and to link professionals and practitioners with their counterparts in the research community.
- Placement program, recruiting and organizing the education of researcher and development professionals in advanced graduate programs.

An example of the conference program is a forthcoming conference on "The Transition to a Market Economy in Eastern Europe" to be held in Prague in March 1991. The conference is jointly sponsored by IPR and the Institutional Reform and the Informal Sector (IRIS), and will bring together outstanding academics from the West with Eastern Europeans who are leading or participating in the reform process. The conference is designed to produce a volume of conference papers that will become a widely cited publication, and the personal contacts that will form the basis of continuing links in the future.

SENIOR RESEARCH FELLOWS

George A. Akerlof

George A. Akerlof is Professor of Economics, University of California at Berkeley. He formerly was the Cassel Professor with respect to Money and Banking at the London School of Economics, and also held positions as senior staff economist for the President's Council of Economic Advisors, and visiting research economist with the Board of Governors of the Federal Reserve System. He is a member of the executive committee of the American Economic Association, an editorial board member for the *American Economic Review*, and an associate editor of the *Quarterly Journal of Economics*. He has pioneered behavioral and sociological approaches to economics, and also has made significant contributions in macroeconomics. He has been a Guggenheim fellow and a Fulbright fellow.

Sebastian Edwards

Sebastian Edwards is the Henry Ford II Professor of International Business Economics, Anderson Graduate School of Management, University of California at Los Angeles. He is a research associate of the National Bureau of Economic Research (NBER) and is co-chairman of the Inter American Seminar on Economics (IASE), organized by the NBER and PUC-RJ (Rio de Janeiro, Brazil). He is an associate editor of *Analisis Economico* and has made significant contributions to international economics, macroeconomics, and economic development. His books include Monetarism and Liberalization: The Chilean Experiment (co-author); Exchange Rate Misalignment in Developing Countries; Debt, Adjustment and Recovery: Latin America's Prospects for Growth and Development (co-editor); and Real Exchange Rates, Devaluation and Adjustment: Exchange Rate Policy in Developing Countries. He has been consultant to the Interamerican Development Bank, the World Bank, the IMF, the OECD, and to the governments of developing nations.

Stanley Fischer

Stanley Fischer is Professor of Economics at the Massachusetts Institute of Technology and a research associate of the National Bureau of Economic Research. His past appointments include a faculty position at the University of Chicago and vice president of development economics and Chief Economist at the World Bank. He is editor of the *NBER Macroeconomics Annual* and has served as associate editor of six other economics journals. He has made significant contributions in the areas of economic growth and development, inflation and its stabilization, indexation, international economics, and macroeconomics. He is the author of the best-selling text Macroeconomics (with R. Dornbusch), Lectures in Macroeconomics (with O. Blanchard), Economics (with Dornbusch and Schmalensee), and Indexing, Inflation, and Economic Policy. He is a fellow of the Econometric Society and the American Academy of Arts and Sciences, a member of the executive committee of the American Economic Association and has held consulting appointments with several governmental institutions.

Bengt Holmstrom

Bengt Holmstrom is the Edwin J. Beinecke Professor of Management Studies at the Yale School of Organization and Management. He has also held positions at Northwestern University and the Swedish School of Economics and Business Administration, and visiting positions at the University of Chicago and Stanford. He is an associate editor of *Journal of Economic Theory*, *Econometrica*, *Finnish Economic Papers*, *Journal of Law, Economics and Organization*, and *Journal of Financial Institutions*. He has made significant contributions in the study of the economics of organization, specifically in the area of incentive theory. He is a fellow of the Econometric Society and a former NBER research associate.

Anne Krueger

Anne Krueger is the Arts and Sciences Professor of Economics at Duke University and a research associate of the National Bureau of Economic Research. Her past positions include a professorship at the University of Minnesota and vice president of economics and research at the World Bank. She is on the boards of editors of *Economics and Finance* and the advisory board of *Revista de Economia Politica*, and is a past member of the editorial boards of *American Economic Review* and *Journal of Economic Literature*. She has made significant contributions to international economics, economic growth and development, and political economy. Her eighteen books include Perspectives on Trade and Development; The Political Economy of International Trade (co-edited with R.W. Jones); Trade and Employment in Developing Countries: Synthesis and Conclusions; and Aid and Development (with V. Ruttan and C. Michalopoulos). She is a fellow of the Econometric Society and the American Academy of Arts and Sciences, chairman of the AEA Commission on Graduate Education in Economics, and has been consultant to numerous government agencies and developing countries.

David Michael Garrood Newbery

David Newbery is Professor of Applied Economics, University of Cambridge, and director of the Department of Applied Economics. He has also held visiting academic positions at Stanford and Princeton Universities, and at the University of California at Berkeley, and was division chief, public economics division in the development research department at the World Bank. He is associate editor of the *Economic Journal* and of the *European Economic Review*, and a fellow of the Centre for Economic Policy Research. He has made significant contributions in the areas of public finance, energy policy, social cost benefit analysis, regulation and privatization, and industrial organization. His books include The Theory of Taxation for Developing Countries (with N.H. Stern) and The Theory of Commodity Price Stabilization: A Study in the Economics of Risk (with J.E. Stiglitz). He is a fellow of the Econometric Society and was just awarded the Frisch Medal of the Econometric Society.

Todd Sandler

Todd Sandler is Professor of Economics and Political Science at Iowa State University. He has also held professorships at the University of Wyoming and the University of South Carolina. He is North American editor of *Defense Economics: An International Journal*, advising board member for *Annual Editions: Violence and Terrorism*, and was associate editor of *Journal of Environmental Economics and Management*. He has done pioneering work on defense economics and the economics of terrorism, and has made significant contributions in the areas of microeconomic theory, and public finance and public choice. His books include The Theory of Externalities, Public Goods, and Club Goods (with R. Cornes); International Terrorism in the 1980's: A Chronology of Events, Volumes I and II (with E. Mickolus and J. Murdock); and The Economics of Defence Spending: An International Survey (edited with K. Hartley). He was a NATO Fellow and has been consultant to the Department of Defense.

T. Paul Schultz

T. Paul Schultz is the Malcolm K. Brachman Professor of Economics and Demography and the director of the Economic Growth Center at Yale University. He has also held positions at the Rand Corporation and the University of Minnesota. He is editor of *Research in Population Economics* and co-editor of the Economic Development Series for Johns Hopkins University Press. He has made contributions in the areas of population research and economic development, including articles in the *American Economic Review*, *Journal of Human Resources*, and *Journal of Political Economy*. He is a fellow of the American Association for the Advancement of Science, a past member of the NBER Conference on Income and Wealth, a member of IUSSP, and has been an adviser and consultant to numerous U.S. and international agencies.

Nicholas Stern

Nicholas Stern is the Sir John Hicks Professor of Economics at the London School of Economics and Political Science. He is also the current chairman of the Suntory Toyota International Centre for Economics and Related Disciplines (STICERD) located at LSE. He has held previous positions at St. Catherine's College, Oxford and University of Warwick. He is the current editor of the *Journal of Public Economics* and an associate editor of the *Journal of Development Economics* and the *Pakistan Journal of Applied Economics*. He has made contributions in the areas of public economics and development economics, and is an expert on tax policy in both developed and developing countries. His books include The Theory of Taxation for Developing Countries (with D.M.G. Newbery) and The Theory and Practice of Tax Reform in Developing Countries (forthcoming with E. Ahmad). He is a fellow of the Econometric Society and a member of the Executive Committee of the International Seminar in Public Economics. He has been a visiting scholar at the International Monetary Fund and at the Institute of Fiscal and Monetary Policy, Ministry of Finance, Japan, and a visiting professor at the Indian Statistical Institute and at People's University of Beijing. He has had numerous policy consultancies for governments of developing countries, public and private bodies in the UK, and international organizations including the World Bank and IMF.

Joseph E. Stiglitz

Joseph E. Stiglitz is Professor of Economics at Stanford University, senior fellow at the Hoover Institution, and research associate at the National Bureau of Economic Research. His past academic positions include professorships at Princeton University, Yale University, and the Drummond Chair in Political Economy at All Souls College, Oxford. He is a member of the executive committee of the American Economic Association and founding editor of AEA's *Journal of Economic Perspectives*. He has made contributions to the theory of market structures, to the economics of the public sector, to financial economics, to macro-economics, to monetary economics, and to the economics of development and growth. He is one of the originators of the "economics of information". He is a fellow of the American Academy of Arts and Sciences, the Econometric Society, and the National Academy of Sciences, and in 1979 received the AEA's biennial John Bates Clark award for the economist under 40 who has made the most significant contributions to economics. He has been consultant in both public and private sectors, including for USAID, the World Bank, the OECD, the Interamerican Development Bank, and the Federal Reserve Board.

Erik Thorbecke

Erik Thorbecke is the H.E. Babcock Professor of Economics and Food Economics at Cornell University. His past positions include chairman of the department of economics at Cornell, a professorship at Iowa State University, and associate assistant administrator for program policy at the Agency for International Development. He is an editorial board member for the *Pakistan Development Review*. He has made significant contributions in the areas of economic and agricultural development and development planning, nutritional and social welfare planning, and international economic policy. Recent publications include Adjustment, Growth and Income Distribution in Indonesia; Economic Policies and Agricultural Performance in Low-Income Countries; Agricultural Sector Analysis and Models in Developing Countries (coeditor with L. Hall); and The Role of Institutions in Economic Development (coeditor with I. Adelman). He has been an economic adviser to numerous U.S. and international agencies, and foreign governments, including USAID, the Food and Agriculture Organization (Rome), and the International Labor Organization (Geneva).

Jean Tirole

Jean Tirole is Professor of Economics at the Massachusetts Institute of Technology. He was formerly researcher at CERAS Ecole Nationale des Ponts et Chaussées and a visiting professor at Harvard University, ENSAE, Ecole des Hautes Etudes en Sciences Sociales, and the University of Lausanne. He is associate editor of *Econometrica* and the foreign editor of the *Review of Economic Studies*. He has made significant contributions in the areas of industrial organization, regulation, organization theory, and the foundations of macroeconomics. He is the author of The Theory of Industrial Organization, and is currently working on two other books, A Theory of Incentives in Regulation and Procurement (with J.-J. Laffont) and Game Theory (with D. Fudenberg). He was elected as a fellow of the Econometric Society in 1986.

Robert M. Townsend

Robert M. Townsend is Professor of Economics at the University of Chicago and a member of the population and the economics research centers of NORC. He was formerly professor of economics at Carnegie-Mellon University. He is a former editor of the *Journal of Political Economy* and is associate editor for the *Journal of Monetary Economics*. He has made significant contributions to study of the effects of impediments to trade, especially the effects of asymmetric information or risk, on market structures using general equilibrium models. He is currently undertaking joint research with ICRISAT (India), and is receiving funding from the Rockefeller Foundation to study high-yielding rice varieties in northern Thailand. He is a fellow of the Econometric Society and a panel member of the National Science Foundation for economics.

Oliver E. Williamson

Oliver E. Williamson is the Transamerica Professor of Business, Economics, and Law, University of California at Berkeley. His previous positions include the Gordon B. Tweedy Professor of Economics of Law and Organization at Yale University and the Charles and William L. Day Professor of Economics and Social Science at the University of Pennsylvania. He is co-editor of the *Journal of Law, Economics, and Organization*, and associate editor of the *Journal of Economic Behavior and Organization* and the *Journal of Japanese and International Economics*. He has done pioneering work on transaction cost economics, and has made significant contributions to the new institutional economics, the theory of the firm, and the economics of organization. His books include The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting, Economic Organization, and Antitrust Economics. He is a fellow of the American Academy of Arts and Sciences and the Econometric Society, and was a Guggenheim fellow. He is also a member of the overseas advisory board of MITI (Research Institute), Japan.

SUMMARIES OF RESEARCH PROJECTS OF SENIOR FELLOWS

GEORGE A. AKERLOF

SUBJECT: Dominant Incentives for the Pursuit of Public versus Private Interests

In studying policy reform, economists need the appropriate model of individual behavior. The usual economic model assumes individualistic values with forward looking rational expectations. These assumptions, while excellent at clarifying economic principles, are not quite realistic in an environment where significant policy reform is taking place. This environment may be characterized more by individuals changing their minds and behavior as they respond to leadership and new ideas.

The first project will explore the consequences of German reunification on employment and internal migration. Worker behavior will be modeled as they react to relative employment conditions and their perception of future opportunities. A second project will develop economic models where individuals are characterized by myopic behavior in their response to leaders or new ideas. In these models individuals fail to fully foresee how they will be affected by their current actions.

SEBASTIAN EDWARDS

SUBJECT: The Sequencing of Policy Reform Processes

The implementation of policy changes in many developing countries is proving to be difficult, stemming mostly from a lack of understanding of the dynamics of reform. The objective of this research is to develop a better understanding of some of the most important aspects of the dynamics of policy reform. This includes the adequate sequencing of reform, the optimal speed of reform, the relationship between structural adjustment and macroeconomic stabilization, and the nature of short term adjustment costs (such as higher unemployment) of these policies. Some of the theories to be used to address these analytical and empirical issues are the new theories of endogenous growth and the new theory of political economy.

STANLEY FISCHER

SUBJECT: Socialist Economic Reform, and Developing Country Industrial and Trade Policy

The aim of this research is to characterize the appropriate role of the state at different stages of development, in different types of country, and in a variety of areas. This will go beyond the usual economic policy measures, to include institutional features such as the legal and administrative frameworks, and political economy issues.

One of the central reforms in socialist economies is privatization. The first project will analyze alternative privatization plans for Eastern Europe within each country's institutional context. The successful plans will have to put in place mechanisms that rapidly ensure private ownership, while at the same time recognizing that modern management and control methods are not yet available. The second project will examine government industrial, trade, and credit policies and private sector responses in Hong Kong, Japan, Korea, and Taiwan, and seek to identify the factors responsible for success or failure.

BENGT HOLMSTROM

SUBJECT: The Financing and Organization of Enterprise

An important question for efforts to stimulate economic growth in developing and transitioning economies, particularly for the restructuring of Eastern European economies, is how should institutions be designed and regulated, specifically financial institutions. What channels of funding should be encouraged at different stages of economic development? What role do/should banks play in the financing and monitoring of entrepreneurial activity? How important are stock markets for the allocation of capital, directly and indirectly? How should stock exchanges be regulated? What is the role of the firm as a financial intermediary? Applying the emerging theory of economic organization to this problem, a theory of capital allocation may be developed that recognizes the distinctive roles of different financial instruments and can help explain common patterns of financing, both in a contemporary and historical perspective. An early objective of this research will be to investigate the financing of entrepreneurial firms.

ANNE KRUEGER

SUBJECT: Political Economy of Policy Reform

In formulating policy it is often essential to understand the interaction of inappropriate policies, and also to attempt to ascertain which are the key bottlenecks to improved economic performance. Closely related is the question of how economic policies come to be altered. This involves both the responses to policy reforms, and the political factors that are conducive or inimical to policy reform.

The objectives of this research are to improve the ability to identify the comparative advantage and disadvantage of the government and of markets, to develop a better understanding of the relative importance of resource accumulation per se and of policies in affecting economic growth and performance, and to explore the political economy of policy formulation and execution in developing countries. To accomplish these objectives, the Turkish reforms of the 1980s will be analyzed, and the influence of development policy thinking in the 1950s and 1960s to actual economic policies will be traced.

DAVID MICHAEL GARROOD NEWBERY

SUBJECTS: The Economics and the Design of Privatization

Privatization has been proposed as the most direct route to major systematic change in the economies of Eastern Europe and the Soviet Union. But transferring property rights without the appropriate legal, regulatory, and competitive structures may be a recipe for massive unplanned redistribution of wealth with relatively little gain in efficiency. The objective of this research will be to analyze the problems of privatizing in relation to property rights, equity markets, and effective regulation. A second research topic will attempt to see whether the case for commodity price stabilization is greatly strengthened by the interaction of multiple market failures and distortions, such as taxation. It will compare this with the case for switching taxation away from industries suffering from compounding market failures, extending the insights of the new growth theory which emphasize the importance of various kinds of externalities leading to economies of scale in an economy.

TODD SANDLER

SUBJECT: Public Goods Investments and Infrastructure

The presence of public goods, externalities, and nonconvexities, and/or the absence of the universality of markets give rise to market failures, especially in developing countries. The objective of this project will be to study the underlying causes of market failures in the developing nations, and to study the design of nonmarket institutions to ameliorate these failures. The preconditions for the formation and design of such structures will be investigated, along with specific design issues. The first part of the research will survey the logic of collective action: when appropriate incentive schemes and institutional arrangements can be used to avoid collective irrationality. The second part will focus on the design of nonmarket institutions to provide public inputs and/or to internalize other forms of externalities. The role of economies of scope in design will be examined, together with that of transaction costs and benefits.

T. PAUL SCHULTZ

SUBJECT: Social Welfare Programs and their Institutional Delivery Systems

The optimal allocation of scarce public resources on social welfare programs (i.e., family planning, health and education) is an important question in all societies, but especially in developing countries. Included in this decision is the choice between institutional delivery system (e.g., public sector and private nonprofit organizations) and the mix of technological inputs (e.g., types of birth control, preventive or curative health care, secondary or higher education) to achieve commonly accepted social objectives.

The objective of this research is to evaluate the marginal effectiveness of public resources to achieve a specified aggregate goal. The first part of the project will analyze the cost-effectiveness of family planning in Thailand, analyzing among other issues, the consequences of scale and private/public delivery system. The second part will look at the private returns to schooling for women and men.

NICHOLAS STERN

SUBJECT: Public Finance in Policy Reform

Many of the central elements of policy reform, such as the removal of price distortions and the decentralization of decision-making to enterprises (often via privatization), have profound implications on public finances. A major portion of government revenues are often dependent upon the existence of the distortions and disincentives whose removal is urged. Other suggested policy reforms will influence government revenue in the opposite direction, including environmental taxes and appropriate pricing for public utilities. These problems can gravely damage reform efforts if not taken into account.

The objectives of this research are to analyze the problems of public finances in economies of changing ownership, managerial, and economic structure. It will look at the effects on public finances of a re-orientation of government activities towards infrastructure and health, education and social security, and away from direct involvement in production. A major purpose here will be to distill what economic theory has to say about tax design for such an environment.

JOSEPH E. STIGLITZ

SUBJECT: Imperfections in Financial Markets in LDCs

Improving the financial markets in the rural sector has become a primary objective of government policy in most LDCs because of the importance of the agricultural sector for these economies. Many of the institutions of the rural sector can be viewed as mechanisms to address the problems of adverse selection and moral hazard, problems which affect all credit markets. The first part of this research will examine how, and the extent to which, a variety of institutional arrangements handle these problems.

The second part of this research will focus on the design of capital market institutions by the former socialist economies. The success of their efforts will depend in part on their ability to replace their current financial institutions with new institutions and new laws which can handle the problems of market economies. This analysis will utilize modern financial markets theory, focusing on the problems of limited and asymmetric information.

ERIK THORBECKE

SUBJECT: Impacts of Adjustment and Reform on Growth, Income Distribution and Poverty, and the Operation of Markets

Policy reform or structural adjustment measures can have significant socioeconomic impacts, particularly on growth, income distribution, and employment. The first part of this project will be to analyze these impacts in order to define the intertemporal trade-offs between alternative policy packages. This would specifically include the effects on the more vulnerable socioeconomic household groups during difficult transition periods and possibilities for protecting these groups.

The operation of markets in developing countries differs from those in developed countries in at least two important ways: in the characteristics of the actors and the items traded, and the markets in developing countries tend to be much more fragmented and compartmentalized. Largely as a consequence of this fragmentation and the variety of different structural and institutional settings and arrangements which coexist, different stylized facts and corresponding models of the operation of specific markets have been proposed in the development literature. The objective of the second part of this project will be to formulate an appropriate conceptual framework for the study of these markets.

JEAN TIROLE

SUBJECT: Incentives and Processes: Applications to Privatization and Corruption

While the current debate on slow versus fast privatization in Eastern Europe points at political considerations as well as feasibility constraints, issues of managerial incentives during the transition process and the concomitant distributional issues are central, and by and large unsettled. Most theories of managerial incentives, corporate finance, and regulation ignore the transition process and focus on the comparison of instruments or incentives in otherwise undistorted economies. The objective of this research will be to analyze the incentives for static efficiency, investments, and market behavior during and after privatizations.

Problems of corruption have become endemic in many developing countries, and are seen as

an impediment to growth and the efficient operation of the economy. The incentives for corrupt behavior by state officials also affects the appropriate role of the state in development. The objective of this part of the research will be to derive insights about which types of policies are more prone to corruption and inefficiency, and about the checks and balances to be set up to prevent abuse.

ROBERT M. TOWNSEND

SUBJECT: Risk Spreading and Risk Sharing Institutions

Various important policy issues in developing countries turn on the nature and level of risk in these economies and how residents respond to this risk. It is generally thought that the poorest residents in high risk environments are especially vulnerable to adverse shocks. The current risk reduction mechanisms of this group may have negative effects for the whole economy, such as increased family size or deforestation activities. Improved insurance-welfare systems may ameliorate many of these negative effects. Also as villages are integrated into the larger national economy, some beneficial village-level credit-insurance arrangements may deteriorate. This would leave individuals more vulnerable to risk, and thus possibly hurt the development process.

The first objective of this project will be the evaluation of insurance-credit arrangements in the villages. This will be done using a complete markets model, testing whether there are key impediments to trade such as private information, spatial separation or limited communication. A second objective will be to evaluate whether private information and incentive problems are restricting community risk sharing arrangements, leading to fragmented land holdings. This study will also attempt to find out if information, communication structures are related to the market or institutional arrangements villagers use to reduce risk.

OLIVER E. WILLIAMSON

SUBJECT: Incentive Alignments and New Institutional Structures

The absence of appropriate institutional structures in developing countries has been a major obstacle to growth. The area of institutional economics, which seeks to identify and analyze those structures in a country which condition economic activity, has been following two disjunct research tracts: the "institutional environment", and the institutions of governance. The institutional environment describes the political, legal, and bureaucratic infrastructure within which economic activity is embedded. The institutions of governance are the market, hybrid, and hierarchical structures within which transactions are executed.

The first objective of this project will be to link these obviously related but currently disjunct part of the institutional economics research agenda. This should yield a variety of comparative statics propositions and permit comparisons across economic systems that hitherto could not be made in a systematic manner. The second part of this project will examine and assess the past and potential applications of transaction cost economics to development.