

Measuring Policy Performance

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Aid Allocation and Selectivity

- Current global economic crisis: harmful to developing countries, with slowdown of
 - Capital flows;
 - Trade;
 - Flows of remittances.
- Official Development Aid: limited and needed resource.
- Context of both scarcity and necessity: **criteria for allocating aid** are an important concern.
- Donors adopt **“selectivity”** criteria.

Measuring Policy Performance

- **Question** *What is the best measure of policy performance?*
- Not only important for aid allocation.
- Of particular importance in context of sub-Saharan countries.
 - Even with revival of growth in SSA in past decade, little progress on path to sustained growth.
 - No important structural changes.
 - Share of manufacturing and formal sector employment still declining. → *Failure of industrial policy.*
- Good measure of policy performance: concerned with policies that would bring about economics transformations, structural changes and **sustained growth**.

Today's Talk

- Focus on **choice of performance indicator**.
- Evaluates relevance of
 - Performance indicators used today, especially **CPIA**.
- Propose other criteria
 - Importance of the **role of the State**: tax revenues. → *Going further than just underlying the need for "good institutions"*.
 - Importance of **export promotion strategies**.
- Present alternatives to CPIA (if enough time...):
 - Outcomes-based indicators, to avoid ex ante conditionality.
 - Other possible allocation tool: aid effectiveness.

Some History of the CPIA

- Country Policy and Institutional Assessment. Since 1977.
- World Bank's tool for aid allocation.
- Aim? Assess "*how conducive* [a country's policy and institutional] *framework is to fostering poverty reduction, sustainable growth and the effective use of development assistance*".

Some History of the CPIA (ctn'd)

- CPIA produced by Bank's own staff: **subjective ratings**.
- In past, CPIA results not made available to the public. Since 2000, public quintile-based disclosure. Since 2005, disclosure of numerical CPIA.

Some History of the CPIA (ctn'd)

- Criteria used in CPIAs have evolved over years.
- Today (2012): 16 criteria divided into four clusters.
 - **Economic Management**
 - **Structural Policies**
 - **Policies for Social Inclusion/Equity**
 - **Governance Rating: Public Sector Management and Institutions**

■ Economic Management

- 1. Monetary and Exchange Rate Policies
 - 2. Fiscal Policy
 - 3. Debt Policy and Management
-
- *Nothing on industrial policy.*

■ Structural Policies

- 4. Trade
 - 5. Financial Sector
 - 6. Business Regulatory Environment
-
- *Nothing on industrial policy.*

- **Policies for Social Inclusion/Equity**
 - 7. Gender Equality
 - 8. Equity of Public Resource Use
 - 9. Building Human Resources
 - 10. Social Protection and Labor

- *Nothing on industrial policy.*

■ Governance Rating: Public Sector Management and Institutions

- 11. Policies and Institutions for Environmental Sustainability
- 12. Property Rights and Rule-based Governance
- 13. Quality of Budgetary and Financial Management
- 14. Efficiency of Revenue Mobilization
- 15. Quality of Public Administration
- 16. Transparency, Accountability, and Corruption in the Public Sector

- Nothing on **industrial policy**.
- “Industrial policy” does not even appear in the 103 pages “Staff Guidance Notes” for the CPIA 2012.
- Nothing on **export promotion strategies** neither...
 - Despite fact that it is widely acknowledged that all successful liberalizations either explicitly or implicitly promoted export growth
 - CPIA only emphasizes necessity to remove trade restrictions.

Differences?

- If compare to what was done e.g. in 2008, *same approach*
 - Despite importance of the crisis;
 - Despite evaluation of CPIA released by IEG in 2009.
- Only difference: ‘*“Macroeconomic management”* now called *“Monetary and Exchange Rate Policies”*’.
- Main recommendation of IEG: *“to strengthen the use of financial indicators in the CPIA write-ups.”*
 - As if what would bring about sustained growth was anything but finance (Stability, Depth, Efficiency and Resource Mobilization, and Access).

Differences? (ctn'd)

- We know from the literature that:
 - Key tradeoff between safe and sound finance and risk taking in financial sectors intermediation between savers and investors.
 - Pattern of financial sector maturation varies considerably among countries.
 - Financial instability can lead to poor growth.
 - Financial opening preceded most crises (Williamson and Mahar, 1998; Kaminsky and Reinhart, 2001).
 - International markets are inherently unstable due to information asymmetries (Griffith-Jones, 2000).
- **No lessons learned from the crisis...**

Staff Guidance Notes

■ Economic Management

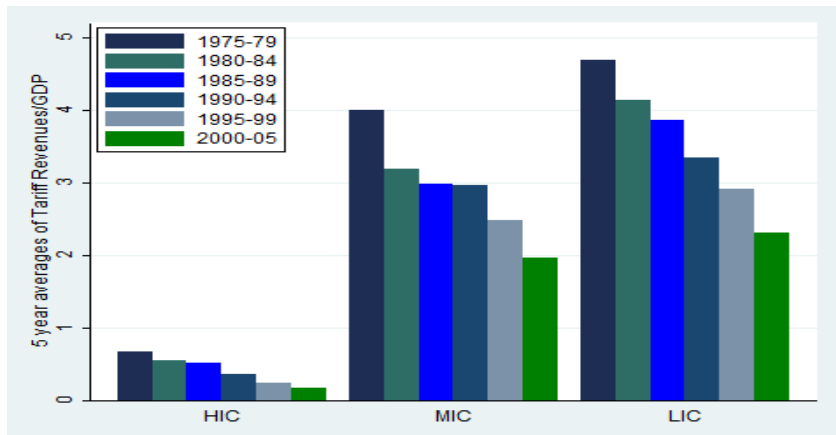
- *“The write-up should focus on the developments of the past one calendar year (...). Unless absolutely necessary, staff are not expected to report developments of more than two years ago in the write-up.”*
- *“Policy performance should be rated against the CPIA criteria, rather than the degree of improvements from the previous year, and in relation to the ratings of the benchmark countries.”*
- Only take into account **short-term**. Not a good approach to bring about structural changes and sustained growth.

Role of the State

- Underestimate the role of the State.
- Especially striking if one considers **Trade criteria**:
“MFN tariffs have been streamlined into a limited number of tariff bands in many countries, so CPIA ratings should reflect how distortionary is the overall structure of trade taxes, including not just tariffs but also other border taxes.”
- Totally ignore the fiscal consequences of trade liberalization.
- *The Fiscal Cost of Trade Liberalization* (Cage and Gadenne, 2012).

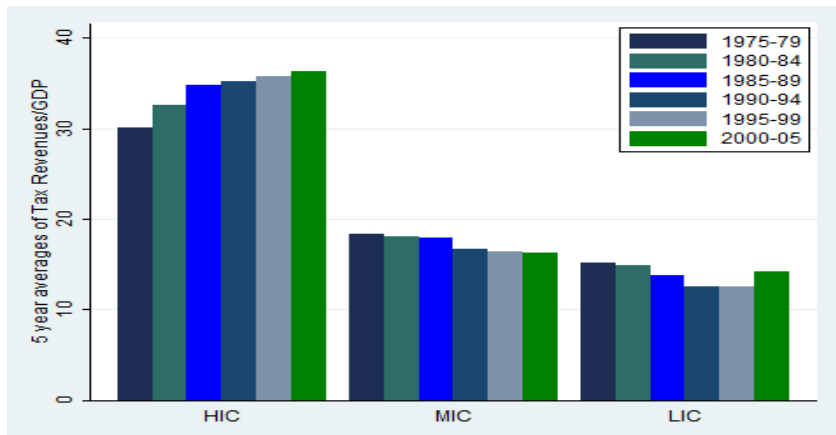
Tax collection from tariffs has decreased since the 1970s...

Evolution of tariff revenues as a share of GDP, 1975-2005



... leading to a decrease in total tax revenues in LICs

Evolution of total tax revenues as a share of GDP, 1975-2005



Role of the State (cnt'd)

- **How to deliver a proper education, health and infrastructure system with tax revenues representing less than 15% of GDP?**
 - Lack of infrastructure: **competitive disadvantage.**
- Trade taxes are an important source of revenue for developing countries.
- These revenues have fallen over the past decades as these countries liberalized trade.

Role of the State (cnt'd)

- Btw 1945-2006 identify 110 episodes of decreases in tariff revenues and consider whether countries recover those lost revenues through other tax resources.
 - Trade taxes fall by 4 GDP % points on average during episodes.
 - Less than half of countries recover lost tax revenues 5 years after start of episode.
 - Picture similar for government expenditures.
- **Pre-existing tax capacity** is needed to levy domestic taxes.
- No taking it into account is an important weakness of CPIA.

Export Promotion Policies

- CPIA only emphasizes necessity to remove trade restrictions.
- While important role of *export promotion policies*.
- Cage and Rouzet (2012): *“Improving “National Brands”:
Reputation for Quality and Export Promotion Strategies”*.
 - Basic intuition: Why do “made in” labels matter?
 - Study effect of firm and country reputation on exports when buyers cannot observe quality prior to purchase.
 - Measure national reputations by analyzing content of US newspaper articles about foreign countries over 1988-2006.
 - More positive news coverage of foreign countries and companies associated with higher unit values of exports to US, particularly in sectors with larger scope for vertical differentiation.

Export Promotion Policies (ctn'd)

- Firm-level demand determined by expected quality, which depends on both past experience with good and country of origins reputation.
- Asymmetric information acts as barrier to entry for high-quality firms but facilitates sales by fly-by-night low-quality firms.
- Countries with bad quality reputation can be locked into exporting low-quality, low-cost goods.
- **Export subsidies** have positive welfare effect on exporting country by improving average quality of exports and ToT.

Export Promotion Policies (ctn'd)

- Some export-led growth strategies for developing countries, pursued in past by East Asian economies, rely on exporting low-quality, low-cost goods and gradually moving up to higher quality, higher unit value goods.
 - China attempting to follow same path.
 - Without policy intervention, may not be feasible if economy trapped in self-fulfilling low equilibrium, in which country's reputation for low quality prevents high-quality firms from entering export markets.
 - Successful export promotion policy: subsidizing exporters initial losses or investing public resources into raising country's perception abroad.

Export Promotion Policies: Japan

- At end of WWII, “Made in **Japan**” goods had reputation for being cheap low-quality goods.
- Japanese companies suffering from inferior “national brand”.
- Currently, Japanese cars and electronics ranked among most reliable in all consumer surveys.
 - Japans pattern of specialization in manufactures has evolved dramatically.
 - Japanese companies achieved such dramatic change by privately imposing strict quality norms.
 - Formed export cartels which provided product quality guarantees: set product design and quality standards; establishe industry brand names; guarantee delivery schedules; mediate disputes btw exporters and foreign buyers.

Export Promotion Policies: South Korea

- Government initiatives also played a key role in the shift in **South Korea's** pattern of trade specialization since the 1970s.
 - Public investment subsidies were tied to exporting activity, as Korean governments were determined to favor the emergence of the country on the international trade scene.
 - These policies resulted in the channeling of credit at negative interest rates to South Korean conglomerates and provided them with insurance against business risk, particularly in the export market.
 - This export-led development strategy is often pointed as having been the hallmark of the East Asian miracle growth.

Export Promotion Policies: China

- Strategy of Lenovo, only Chinese company to get a worldwide sponsorship for the Beijing Olympics.
- With Western sounding name, legacy of IBM, brand name and technology and chief executive from Dell and NCR, Lenovo Group not a company that most Americans would assume is Chinese.
- Exactly what company aims for, although Lenovos largest shareholder is Chinese gvt, aware of fact that American consumer associates Chinese products with cheap and unreliable.
- In some sectors, Chinese firms even relocating factories or assembly lines in Europe to obtain made in Europe label: Chateauroux Business District in France.

Relevance of the CPIA?

- 4 other main weaknesses of CPIA:
 - (i) Ex ante conditionality
 - (ii) "Hidden" conditionality
 - (iii) "One-size-fits-all" approach to development
 - (iv) Bad predictor for economic growth

Ex Ante Conditionality

- **CPIA relies on policies rather than on outcomes.**
- Corresponds to a model of **ex ante conditionality**.
- Problem:
 - Ex-ante conditionality has not worked (Stiglitz, 1999: "*Good policies cannot be bought*").
 - Against democratic accountability and economic sustainability that require recipient takes ownership of development strategy.
- However, fundamental changes in CPIA design: **relevance of current indicators** (no more "*Washington Consensus*" type indicators). But hidden conditionality?

Hidden Conditionality?

- Fundamental changes in CPIA design and relevance of current indicators but...
- ... World Bank accused of using some “**hidden conditionality**” reflecting particular and tendencious view of what constitutes “good policies”.
- See e.g. Van Waeyenberge (2006): possibility that imperatives that have disappeared from narrative guidelines of CPIA have become ‘embedded’, and now steer CPIA exercise in less visible ways.
- Striking is the high *positive* correlation that one finds between the CPIA and developing countries votes in UN with US

One-Size-Fits-All?

- View that CPIA relies too much on an "one-size-fits-all" approach to development...
- ... while "*there is not universal recipe*".
- CPIA does not correspond to empirical reality of development: being the same for every country, relies too heavily on uniform model of what works in development policy.
- Moreover CPIA underlines very specific policies... and forgets other (very important) ones...
- Finally, CPIA is not a good predictor for economic growth.

Kanbur's Proposal

- Kanbur (2005): CPIA implicitly relies too heavily on uniform model of what works in development policy.
- Proposition: **introduce outcome variables in CPIA.**
- Main idea:
 - Measure needs side by levels of outcomes;
 - While measuring performance side by rate of improvement of these outcome variables over given period of time.

Advantages of Kanbur's Proposal

- Relies on **actual performance** and not on **ex-ante conditionality**.
- **Ex post conditionality**: rewards countries that used past aid well without conditions.
- In the spirit of Paris Declaration (2005) and Accra Agenda for Action (AAA) (2008):
 - *"Developing countries and donors will work together at the international level to review, document and disseminate good practices on conditionality with a view to reinforcing country ownership and other Paris Declaration Principles by increasing emphasis on harmonised, results-based conditionality."*

Other possible approach

- Using directly aid effectiveness as a productivity measure.
- Measure of country performance wrt. aid effectiveness, not of country performance wrt. outcome.
- Spirit of outcome-based allocations: ex-post rather than ex-ante conditionality.
- But more sophisticated tool: help to overcome difficulties of outcome-based criteria.
- Does not reward "good luck": tool to reward good "**aid performer**" not good "**growth performer**".
 - Won't develop this proposal here but show in previous work that it leads to a different (more efficient) aid allocation than CPIA.

Conclusion

- If CPIA tool to allocate aid to countries with "good institutions" or "policies", ok – even if criteria can be questioned.
- But official goal of CPIA: poverty reduction, sustainable growth and effective use of aid.
- From this point of view, not good tool.

Conclusion (ctn'd)

- Most importantly, CPIA not concerned with policies that would bring about economics transformations, structural changes and sustained growth.
 - In particular, no possible sustained growth without high enough tax revenues (problem of weak States, especially in SSA).
 - Necessary to think about how to implement an efficient industrial policy.
 - Important role of export promotion policies.