The Frank E. Seidman Distinguished Award In Political Economy

Acceptance Paper By
Anne O. Krueger

Lessons from Developing Countries About Economic Policy

Award Bestowed October 2, 1993
in Washington, D.C.

RHODES COLLEGE
Memphis, Tennessee

The Frank E. Seidman Distinguished Award In Political Economy

Objective

The Seidman Award recognizes distinguished contributions to Political Economy by economists or other political and social scientists who, by conventional and/or innovative approaches, have demonstrated their dedication to improving human conditions. The Award seeks to honor scholars who have advanced general understanding of the roles of democratic values, public institutions, government policies, private enterprises, and free markets in promoting economic well-being and social welfare.

Selection Procedure

Each year nominations are solicited worldwide from the economics and social science professions. Following a defined process, the recipient is chosen by the Board of trustees, acting upon recommendations of a Selection Committee composed of eminent economists appointed for limited terms. The Award is presented annually at a formal banquet hosted by the Award's Trustees and Rhodes College.

The announcement of the recipient of the Award will be made in the Spring by the Board of Trustees of the Award and by Rhodes College.

Mel G. Grinspan
Distinguished Service
Professor Emeritus
Award Director

ANNE O. KRUEGER

Recipient of 1993
Frank E. Seidman Distinguished Award
In Political Economy

PRESENTATION OF THE AWARD
BY JAMES BUCHANAN
1984 AWARD RECIPIENT
1986 NOBEL LAUREATE IN ECONOMICS
CENTER FOR STUDY OF PUBLIC CHOICE
GEORGE MASON UNIVERSITY

I am pleased that, on this formal occasion, the sponsors of the Frank E. Seidman Award have asked me to deliver the introduction for this year's recipient. Before doing so, however, I should like to say something about the new venue for this ceremony. I can fully understand and appreciate the compelling argument to the effect that any award ceremony in "Political Economy" should appropriately be made in the place where the economy is most political. But I can also appreciate the opposing argument that might be made to the effect that the central elements of "Political Economy" can only be understood when looked at from afar, from a detached perspective, and away from the scene of action itself. If I personally add to this my loyalties to my native state of Tennessee, I come down, on balance, with an expression of some regret that the Awards ceremony has been shifted away from Memphis to Washington. There are ceremonies enough in Washington; I should have preferred that the Seidman Awards ceremony, in particular, be graced by the ambiance of the traditional Memphis setting.

But enough of my misgivings about venue. Let me proceed to my almost unalloyed pleasure in presenting the recipient of the Award. I say "almost" and for similar reasons to my thoughts about venue. Until about a month ago, I had anticipated being able to present Anne Krueger to you, as a most distinguished leader from a southern academic institution, Duke University. And, again, my loyalty as a native southerner gave some evaluational impetus to my intended laudation, even in the recognition that there are no regional qualities that matter in modern academia. What I learned a month ago is that Anne Krueger, after six distinguished years at Duke, has shifted her academic base to Stanford University, an appointment that signalled to me that the new leadership at Stanford is indeed likely to insure that, despite its lotus land location, that university will assume first rank among its peer institutions.

Let me now talk about Professor Anne O. Krueger, the recipient of the

1993 Frank E. Seidman Award in Political Economy. She is, first of all, a true "political economist". She has examined, first hand, the institutional realities that are involved when countries seek to improve the operation of their national economies through political means. In a fundamental paper entitled, "The Political Economy of the Rent Seeking Society", published in 1974, Anne Krueger made the definitive contributions in measuring and evaluating the costs that the political assignment of import quotas in Turkey and in India imposed on those countries. In the process of completing that analytical and empirical research, she invented a term that has become familiar in modern economics, the term "rent-seeking", by which economists now mean the investment of resources in trying to secure the differential profits or "rents" that are artificially created by the political restriction on the free play of market forces. Anne Krueger, along with Gordon Tullock, and Richard Posner, is given credit throughout the economics academy for opening up what has become an active and productive research program—the theory of rent-seeking. Among these three seminal contributors, Krueger alone is credited with inventing the term itself.

Professor Krueger's central interest has long been in understanding how economies grow and develop, and particularly in how misguided political intrusion into the workings of markets, both internal and external, can stifle and thwart the potential for growth that everywhere exists. She has examined these problems in many countries—Turkey, Korea, India, Brazil and New Guinea. Anne Krueger had the opportunity to put her ideas into practice when she joined the World Bank, where she served as Vice President from 1982 until 1987. I can, at this point, tell you that, at a conference in São Paulo, Brazil, last month the man who is perhaps the leading expert on development in Latin American countries told me that, in his view, Anne Krueger is the single person who was primarily responsible for turning the World Bank focus around and in the direction of economic liberalization.

All of us know many of the familiar complaints about economists as concerns their differences, one with another, on many issues, in political economy and other things. These criticisms fail to mention that, on some basic issues, economists agree, and, indeed, we sort of define economists by such general agreement. One of these issues that has helped to define economists for a full two centuries has been that of free trade. The central principle of our science is, after all, the principle of mutuality of advantage

from trade and exchange. And, since Adam Smith, economists tend to support measures that open up markets to expanded trade, and they tend to oppose measures that represent political restrictions on the expansion of markets. It is in this context that I consider it particularly appropriate that this year, 1993, the Frank E. Seidman Award is being made to a political economist who has been in the forefront of modern discussion. Anne Krueger does more than pay lip service to free trade; she gets her hands dirty by looking in detail at the institutions of political economy, and she searches out protectionism wherever it may be found, even if it often masquerades under free trade banners and with free trade sloganeering. The timing of this Award could not have been more propitious, even down to the month and day of this ceremony. When the currently discussed issue in "Political Economy" is one that involves the potential expansion of the American market, we could scarcely have nominated an economist who more adequately represents what the "science of political economy" is all about than Anne Krueger.

LESSONS FROM DEVELOPING COUNTRIES ABOUT ECONOMIC POLICY

Anne O. Krueger

For many years, economists based their policy prescriptions on several, apparently innocuous, assumptions. First, it was presumed, usually implicitly, that the entity undertaking the policy - presumably the government - had the best interests of the citizenry as its objective function. Second, it was assumed that those seeking to optimize social welfare would automatically have full information on which to base their decisions. Third, policies were analyzed as if they were costless to impose, administer, and enforce.

On the basis of these assumptions, it was easy to conclude that the government *should* intervene whenever there *might* be market failure (indeed, on these assumptions there was really no evident reason why the government should refrain from any activity: it could perform at least as well as private parties). This approach to policy formulation was widespread when policy makers in developing countries began addressing their objectives of more rapid economic growth and rising living standards. The levels of poverty that were prevalent were themselves sufficient to convince most observers that market failures must have occurred. Moreover, given the assumptions about the costlessness of government intervention, little need was seen to investigate the nature, magnitude, or correctibility of failure: it was taken as self-evident that government intervention could achieve the desired goal.

In the years after the Second World War, most developing countries' governments adopted a series of economic policies intended to achieve economic development that were based, in large part, on these premises. Policy stances were very similar across a large number of developing or, as they were then called, underdeveloped economies.

Policies were usually set forth in a "plan". It was thought that developing countries were poor because they had little capital per man with which to work, so the plan focussed first on estimating a target rate of economic growth and a needed rate of investment in order to attain that target (based on an estimated or assumed incremental capital-output ratio).

The plan then set forth measures to increase public savings and investment and to encourage private investment. For this latter purpose, interest rates were artificially suppressed and credit rationing was generally adopted

so that credit could be directed to firms undertaking projects in favored industries. For the same motive, efforts were made to keep imports of capital goods cheap. Perhaps most important, however, was the adoption of "import substitution" as a policy to induce private investment in activities to replace imports. It was (probably correctly) generally believed that industrialization was an essential concomitant of rapid growth, and (probably incorrectly) that new entrants in developing countries, as infant industries, could not possibly compete with established firms in industrial countries and would require a "hothouse" or protected environment. Hence, policies were prescribed in plan documents to provide automatic protection against imports (usually by prohibiting them) once domestic productive capacity had been established. Both SOEs and private firms were encouraged to enter new industries. Often, the development plans identified the new industries to be established, and set forth a delineation of those to be undertaken by private entrepreneurs and those to be undertaken by SOEs.

For a variety of reasons, policies also included a number of controls and regulations over much private economic activity. These included price controls for a number of commodities, regulations governing private firms' rights to expand output or capacity (based on the presumption that if expansion were not controlled, resources might be directed into lines other than that called for by the plans), and, as already noted, credit rationing. In many countries, there was also an investment license required before private firms could invest to insure that scarce investible resources were allocated to the activities deemed by the policy makers to be most desirable. As will be discussed later, control over imports, and import licensing procedures, gave the authorities an instrument which affected the ability of virtually all firms to produce, and the receipt of import licenses often determined production levels.

Private firms were generally precluded from entering certain fields of endeavor and direct government ownership through SOEs was favored. Activities reserved to the public sector usually included not only some new manufacturing activities, as already mentioned, but also:

- agricultural marketing boards (which usually were given monopoly positions vis-a-vis peasants on the purchase and marketing of exportable crops and major grains as well as monopsony position as the sole suppliers of agricultural inputs);
- many mining activities;

- some financial services (especially banking);
- even such activities as tourism.

There were a variety of controls:

- over the allocation of credit (for many of the same reasons as investment licensing);
- over new investment activities through licensing;
- regulation of the labor market (covering not only minimum wage rates but also workers' rights to their jobs, required training programs for workers and educational facilities for their children, and a variety of other conditions of employment);
- controls over prices of a number of goods deemed essential or regarded as being subject to monopoly influences.

To be sure, governments as well devoted attention and resources to increasing access to education and health services, increasing infrastructure capacity in power, transport, and communications, and such other more traditional government activities such as agricultural research and extension and urban amenities. But relative to the emphasis placed in the nineteenth century on this latter group of functions by governments of the now-industrialized countries, the administrative capacities and political attentions of governments in developing countries were much more heavily oriented toward the first group of functions. Indeed, politicians and civil servants were eager to fill jobs in these new areas, which had a certain glamour, and reluctant to be consigned to such unglamorous tasks as rural road maintenance, dredging of ports, investments in cleaner water supplies, or rural public health.

For a variety of reasons, the initial results of the entire set of policies undertaken in "development plans" appeared satisfactory. Growth rates of real GDP, and per capita income, were well above their historical levels. In part this was attributable to domestic policies which accelerated investment, increased levels of education, and improved infrastructure, as most of these had large positive real returns. Some investments in agriculture and in new manufacturing industries also had sizeable payoffs, as "easy" import substitution investments were undertaken first. In addition, the world economy was buoyant, which provided an atmosphere conducive to rapid growth. Initially, all these positives more than outweighed any negatives arising from the regulations, controls, and interventions of the government itself.

Over time, however, the positives became smaller and the negatives

became larger, so that economic growth slowed down in most developing countries despite rising rates of savings and investment. It is on the reasons for this shift in the balance between the benefits and costs of interventions that I shall focus these remarks. For, the evolution of policies and their costs and benefits is what provides the lessons from developing countries for the theory of economic policy formulation more generally.

The reasons for the gradual shift in the balance of costs and benefits include a variety of economic phenomena, well known to most in this audience - the costs of resource misallocation, rent seeking, bureaucratic self interest, and so on - but also a variety of political-economic interactions, which I shall term the "dynamics of policy evolution" which have been less widely recognized.

In tracing the evolution of policy and of the political-economic interactions that followed, subsequent to decisions on the initial policy stance, a starting point is to note that in many developing countries, the initial policy set was chosen by political leadership which had unusual opportunities in that there were many fewer than usual political constraints. Often, the leadership could and did behave as benevolent social guardians in the sense assumed by economists. That is, the choice of economic policies was dictated by the beliefs of the leadership (behind which there was often a very strong consensus of the "modernizing elite") as to what constituted policies that would promote the social good. Thus, Nehru, Sukarno, U Nu, Ataturk, Nasser, Prebisch, arguably Nkrumah, and many others all adhered to much the same set of ideas, and most observers would credit those individuals with genuine commitments to the objectives of raising living standards and economic development in their countries. In that sense, the first premise of economic policy formulation - that policy makers had as their objective the social welfare of their people - was met, at least initially.

As already stated, growth rates were initially satisfactory, although there were distortion costs. These costs surfaced both in macroeconomic results and in administrative and technical problems, and as they did so, they prompted a first round of policy changes. On the macroeconomic side, the primary symptom of difficulty was usually foreign exchange shortage, as slower than anticipated growth of foreign exchange receipts (as resources had been diverted into new import-substitution activities) was accompanied by a more rapid increase in the demand for foreign exchange than had been forecast. Because developing countries were, in the 1950s and 1960s, so heavily specialized in primary commodity production, it was perhaps

inevitable that difficulties associated with the foreign sector were the primary symptom of problems.

In most developing countries, however, inflationary pressures were also somewhat greater than anticipated, as forecasts of government expenditures were generally below realizations, while government receipts often fell short of (optimistic) expectations. With inflation proceeding at rates above the world level, one response might have been to alter nominal exchange rates. However, the desire to encourage capital goods imports (and perhaps other, nationalistic, considerations) induced leaders in most countries to maintain their nominal exchange rates for long periods of time and to adjust them, if at all, in proportions less than the inflation differential. The result was, of course, increasing pressure on the balance of payments, further curtailment of imports, and hence further inflationary pressures.

Administrative difficulties also appeared. Delays and bottlenecks in distribution of fertilizer and other agricultural inputs, or in collection of crops by marketing boards, were widespread and led to repeated efforts to "reorganize" marketing boards. Rising costs of these activities led to farmers' receipts of a lower percentage of international prices of their commodities as domestic costs of collection and distribution rose. In turn, that resulted in reduced crop collections and, in some countries, even falling output of export crops. SOEs in manufacturing also incurred large losses, instead of generating the resources that had been expected with which to finance additional government investments. The emergence of smuggling and other forms of evasion of trade and exchange restrictions, was yet another difficulty encountered within a fairly short time after development programs had been undertaken.

The list could be extended considerably, but for present purposes, the point is that the initial policy stance selected by governments was not sustainable. Inevitably and probably understandably, the response of the authorities to these difficulties was to attempt to "rationalize" regulations. Once foreign exchange became scarce, for example, import licensing was begun or intensified. With foreign exchange "shortage", efforts were made to categorize different imports according to their "essentiality". Classifications often began with a simple division into consumer and producer goods; with increasing foreign exchange difficulties, that was followed with further classifications of "essential", "semiessential", and "other" intermediate goods and raw materials, capital goods imports for new projects, replacement items, and so forth.

As the classifications increased in complexity and as the value of import licenses increased, the profitability of evasion of regulations rose. Rent-seeking in many forms emerged, as private individuals sought through various means to obtain import licenses while officials in the government sector queued for "good" jobs and young people invested in education and training and then waited for their employment in the public sector. Smuggling and underinvoicing of imports increased; so, too, did misclassifications of imports, as producers added unneeded parts (for resale) to orders of machinery and equipment, arranged for goods to be classified into categories eligible for importation, and otherwise sought to profit from their access to import licenses. Once it was recognized that that was happening, efforts to enforce the regime intensified. That, in turn, meant hiring additional bureaucrats to scrutinize and pass on import license applications (to insure that unnecessary parts were not included), to establish "fair prices" for imports (and exports) to prevent underinvoicing (and capital flight), to patrol borders and intercept smugglers, and so on.

But the subsequent increase in delays in processing import license applications, combined with the continued tendency (as additional resources were attracted into newly profitable lines related to evading the import regime and import substitution) for growth of foreign exchange earnings to lag, all increased the restrictiveness of the regime. Just as policy makers were investing additional resources into enforcement of the regime, private individuals found it profitable to invest additional resources in exploiting the opportunities for evasion of the regime.

What was true for allocation of foreign exchange was equally true for agricultural pricing policies, investment licensing, price controls over consumer goods, and other policies. In some cases, the costs of policies were additional resources devoted to seeing the profits created by them (rent-seeking, additional bureaucratic personnel and so on); in other cases, the costs were more explicit and borne by the budget as additional imports of grain were needed to maintain low consumer prices, or as losses of SOEs were met by the government or the central bank.

National savings rates rose by as much, if not more, than was initially hoped, and, of course, investment rates rose at least commensurately as a generalization with few exceptions (most being found in East Asia). Almost everywhere, however, growth rates rose by much less and, indeed, after a period of time began falling, as the inefficiencies of controls resulted in falling real rates of return on investment.

A major lesson that emerged from all this focussed on the sustainability of policy, both in an economic, and in a political sense. Some policies are unsustainable simply because, e.g. the authorities cannot continue borrowing at the going rate. Other policies are unsustainable because they eventually have consequences that erode political support. It is these lessons, of the politicaleconomic logic of policy evolution that is generally applicable and has emerged from the experience of developing countries. As described so far, benevolent social guardians adopted policies. Those policies met with both political and market responses which called for amendments to policy. Those amendments often increased the economic costs of the initial policy stance.

But, in addition, the amendments themselves had political consequences. In the sequence I just described, the profitability of obtaining import licenses resulted in the emergence of a group of private individuals whose livelihood depended on their knowledge of how to obtain licenses (or smuggle goods across the border, or arrange for over or underinvoicing and the deposit of the foreign exchange proceeds abroad). It also resulted in an increase in the number of bureaucrats employed to administer the policies. In addition, the political influence of export interests diminished as exporting became less profitable and as entrepreneurs shifted from exporting to import-substitution industries. Thus, political pressures for an open trade regime and a realistic exchange rate diminished in response to policies which shifted toward a more restrictive trade and payments regime.

The net outcome was the creation and expansion, both in the private and in the public sector, of groups with an interest in the preservation of the economic policies. Those groups had economic resources and knowledge with which to oppose any effort to dismantle controls, and an increasing number of votes in support of sustaining some variant of existing policies. In all cases, the rhetoric surrounding their advocacy naturally centered on the various social gains allegedly achieved by their activities.

In many instances, the upshot of all this evolution over a wide range of policies was the recognition by some of those among the benevolent social guardians who initially formulated policy that things had gone awry. When that group suggested the abandonment of the initial policy stance, however, opposition emerged from a group which had in the first instance been created by the policies!

Thus, economic policies produced political support groups which perpetuated the policies even when their initial supporters wished to reverse

position. The outcome was the entrenchment, and irreversibility, of policies completely unintended by initial formulators.

But that is only one component of the story. Recall that I said initially that the political imperative was perceived to be that for economic growth. A second consequence of the initial policy stance was that, although growth initially was fairly rapid - especially by historical standards - there were a number of features that tended to slow it down. These included, among other things, the rising cost of additional import-substitution activities (as low cost ones were undertaken first), the increasing size of SOE deficits even relative to GDP as inefficiencies compounded, the increasing costs of distortions associated with increasingly restrictive licensing procedures, and a number of other mechanisms set in motion through the initial policy stance.

However, the politicians had sold the economic policy stance on the grounds that living standards would rise. In many if not most countries, regardless of the de jure or de facto form of government, maintenance of political support for the regime was contingent on maintenance of growth rates.

Again, a process had been set in motion. At first, successes in raising the savings rate were so great that the rate of investment rose more rapidly than the return on investment fell. Over time, however, the feasibility of increasing savings rates (except in centrally planned economies) further diminished, while the return on investment continued falling. To thwart the erosion in growth rates, many countries' governments then maintained their investment programs through borrowing from abroad.

Starting with low levels of debt, this strategy was initially feasible, and of course, debt servicing needs were initially small. Over time, however, as the incremental output-per-unit-of-capital ratio continued dropping, the rate of borrowing as a percentage of GDP rose, and, of course, debt servicing obligations rose even faster.[1]

In many instances, the political response was to undertake enough adjustments in macroeconomic policy (a nominal devaluation, reduction in the magnitude of the fiscal deficit often through measures which postponed expenditures rather than addressing the underlying problem, raising prices of outputs of SOEs on a once-and-for-all basis, raising the nominal interest rate) to reduce the demand for foreign exchange, to increase foreign exchange earnings, and to persuade international creditors to reschedule debt servicing obligations. Once the balance of payments was

thus under less pressure, policies gradually reverted to the status-quo-ante, and the same pressures which had earlier led to difficulties reasserted themselves, albeit with more controls, less efficient economic activities, and hence with lower growth rates for given rates of investment. For a period of time, a "stop-go" cycle was experienced, as balance of payments pressures and debt servicing difficulties forced the acceptance of a "stabilization program". Once foreign exchange availability increased, earlier policies were resumed. Growth accelerated for a while until balance of payments difficulties again emerged.

But each round of the cycle started with higher initial levels of debt, higher incremental capital output ratios, and political demands for even more government expenditures. The necessary magnitude of capital inflows to sustain GDP growth increased. Augmenting domestic savings by as much as 5-10 percent of GDP, growth rates could be sustained, at least for a while. But, at some point, debt-servicing difficulties became acute (if nothing else happened first).

Ultimately, of course, growth rates slowed in any event as foreign creditors would no longer lend sufficiently to finance the necessary increase in investment to maintain the growth rate. When that happened, the choices facing policy makers were reduced still further: either resort to deficit financing to sustain investment or accept lower growth.

Again, the choice in many countries was for deficit financing, and hence, for rising rates of domestic inflation. In some instances (one thinks of Brazil), the process still continues.

But, for present purposes, the point is that slowdowns in growth, debtservicing and foreign exchange crises (with the accompanying jolts of macroeconomic adjustment and growth slowdowns), and rising inflation are all phenomena which undermine political support for a regime.

As political support diminishes, there can be three possible reactions: 1) politicians can try to "buy" support through increasing expenditures directed at benefitting specific key constituency groups; 2) politicians can recognize that they are on a suicidal path and alter policies; or 3) governments can change as the body politic rejects the economic consequences of past policies.

The most frequent response, "buying" support through increased public works, entitlement schemes, or other measures, becomes increasingly difficult over time without intensified inflation or diversion of further resources from investment. While it therefore happens (and in the short

term therefore results in policy measures which tend to reduce growth rates even further), it cannot generally endure (unless good fortune buys time through temporary improvements in the terms of trade, discoveries of oil, or similar events).

Whether politicians in the ruling party decide to reverse policies, or an alternative government comes to power, the end result is "policy reform". In a sense, "policy reform" starts in a period when "politics as usual" is suspended because of the perceived economic difficulties.

By the time the political leadership decides upon reforms, however, there are large groups in society who perceive themselves to be benefitting sufficiently from the present system so that they oppose change. Thus, even when it was recognized in India, for example, that the control system was adversely affecting growth, it was difficult to alter because of opposition by bureaucrats (of whom it is estimated there were 17 million responsible for one or another aspect of administration of existing controls), by employees in public sector enterprises, by individuals whose livelihood is made through serving as intermediaries between government officials and private parties wishing to achieve results, and by private sector owners and workers who perceive that they would be adversely affected by a change in the regime.

Policy reform can, of course, be of the "too little, too late" variety, and do no more than promise results and therefore buy time for a new government, in which case the downward economic spiral will reassert itself. The opposition of the groups just cited is a powerful factor in leading to that result, as the extent of change on which political consensus can be reached may be less than the necessary "critical minimum" to change economic behavior and the allocation of resources.

However, in some instances, when the economic situation became sufficiently desperate, "politics as usual" was suspended, and policy reforms have been undertaken which are sufficiently far reaching so that there are fundamental changes in incentives within the economy and in the relationship between private economic activity and government regulations and controls.

Interestingly, the political-economic interactions that followed from the choices of policies in the early days of development resulted in a "vicious circle" as deteriorating economic performance resulted in erosion of political support, induced further economic controls which further impaired economic efficiency, and so on.

Successful policy reform has, by contrast, resulted in a "virtuous" circle. In that process, rising per capita incomes increase political support for the regime, which in turn enables further economic liberalization. That liberalization permits results in further acceleration in the rate of economic growth, which then enables those in power further to reduce government expenditures aimed at "buying" support (which have low or negative social product) and reallocate them to infrastructure and other uses with positive real rates of return.

In contrast to the self-reinforcing (in the short run) but ultimately unsuccessful nature of policies in which controls over private activity and government expenditures as a percentage of GDP rise over time, the virtuous circle appears to permit continuation of policies, if not indeed liberalization once the reforms have been in place long enough to be credible and to induce private individuals to base their behavior on the expectation that the new set of incentives will indeed endure.

This contrast in policies goes further: the policies of tight controls and increasing public sector involvement in the economy are fairly easy both politically and economically to initiate and can appear to bring short term results; in the longer term, however, they become increasingly difficult to administer and yield lower and lower returns. Liberalization, by contrast, is both politically and economically difficult (this latter because the responses are normally delayed until credibility is achieved) to launch, but momentum for further liberalization (and the economic returns to improved policies) increase over time. Once liberalization begins to yield returns, political groups supporting the new policies begin to emerge. In that sense, political support can be endogenous for liberalization, just as it is for policy regimes of extended government intervention.

A number of questions remain. First, we are witnessing pressures for political liberalization in many of the countries where liberalization of the economy was earlier successfully undertaken; it may not be possible for political suppression to coexist with rising levels of per capita income above some critical point: based on observations in East Asia, that critical level might be around $5,000. Second, there are a variety of as yet unresolved questions as to how best to achieve the initial stages of policy liberalization, from a position in which the earlier policies of controls that I described are entrenched. Those questions include both the speed with which various reforms can optimally be undertaken and the extent to which appropriate policies can buffer the shock to groups negatively affected by reforms

without eroding the impact of policies so much that reforms fail to have their intended results.

What is clear, however, is that there are many instances in which one cannot analyze the effects of a proposed economic policy on the presumption that that policy, once effected, will remain unaltered indefinitely. The political and economic responses to policy may induce endogenous changes in it, so that those favoring the initial policy might well oppose it if further consequences were known. Conversely, one cannot take the alignment of political forces as entirely exogenous. Economic policies can bring about the emergence of new groups in support, and can weaken the economic and political strength of groups opposing, those policies.

While "windows of opportunity" permit ideas and economists a major role in policy formulation in times of crisis or major upheaval, the return to normalcy greatly reduces the scope of the exogenous influence of ideas and technocrats on policy formulation.

Any understanding of the evolution of economic policies in developing countries, therefore, must take into account both the shift in political equilibria brought about by more-or-less exogenous initial economic policy decisions, and the shift in economic equilibria brought about by shifts in economic policies.

It is evident from the experience of the countries that have successfully reformed policies that the payoff for shifting toward a virtuous circle can be enormous. Better understanding of the political-economic interactions that can enable this to happen is therefore of major importance for improving the development prospects of those countries still mired in the "stop-go" cycle of detailed controls and intervention and gradually decelerating economic performance.

[1] Foreign aid was used to the extent it could be obtained. Direct private foreign investment flows also funded current account deficits. But borrowing from private foreign sources (primarily commercial banks) was the chief financing mechanism, and for simplicity, I shall couch the discussion in terms of debt and debt servicing. When direct foreign investment, or other forms of equity investment, were used, demands for foreign exchange for repatriation of earnings from profits resulted in the same pressures as did debt servicing obligations.

1993 BOARD OF TRUSTEES

LAWRENCE J. SEIDMAN — Retired Chairman, BDO Seidman
Chairman of the Board of Trustees

ROBERT BUCKMAN — President, Chairman, Chief Executive Officer
BULAB Holdings, Inc. and Buckman Laboratories International

JAMES H. DAUGHDRILL, JR. — President, Rhodes College

ZVI GRILICHES — Past President, American Economic Association
Professor, Department of Economics, Harvard University

JOHN M. PLANCHON — Chairman, Department of Economics and Business Administration, Rhodes College

THOMAS C. SCHELLING — 1977 Award Recipient
Distinguished Professor, Economics and Public Affairs, University of Maryland

L. WILLIAM SEIDMAN — Chief Commentator, CNBC
Former Chairman, Federal Deposit Insurance Corporation
Former Chairman, Resolution Trust Corporation

AMARTYA K. SEN — 1986 Award Recipient
President, American Economic Association
Lamont University Professor, Harvard University

HERBERT STEIN — 1989 Award Recipient
Former Chairman, President's Council of Economic Advisers
Senior Fellow, American Enterprise Institute

P.K. SEIDMAN — Attorney
Chairman Emeritus

ROBERT M. SOLOW — 1983 Award Recipient
Consultant to the Board — 1987 Nobel Laureate in Economics
Institute Professor of Economics, Massachusetts Institute of Technology

MEL G. GRINSPAN — Distinguished Service Professor Emeritus, Rhodes College
Director of Award

1993 SELECTION COMMITTEE

KENNETH J. ARROW — 1972 Nobel Laureate in Economics
Professor of Economics, Stanford University

JAMES BUCHANAN — 1984 Award Recipient
1986 Nobel Laureate in Economics
Center for Study of Public Choice, George Mason University

VERNON L. SMITH — Regents Professor of Economics,
University of Arizona

JAMES TOBIN — 1981 Nobel Laureate in Economics
Sterling Professor of Economics Emeritus, Yale University

HAROLD F. WILLIAMSON, JR. — President,
International Honor Society in Economics
Professor of Economics, University of Illinois