OLD ENGLISH SHEEPDOGS AND ECONOMISTS

by

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Reading David Dollar's article in this Review's last issue, entitled "Eyes Wide Open," made me feel as if I were in the company of an alert Old English Sheepdog. Like so many Economists, Dollar was trying to see -- and thought he was indeed seeing -- everything in his purview but actually was seeing only a small fraction of what was staring him straight in the face.

What Dollar did see is that foreign aid over the past two decades failed to make a dent in the growing income differentials between the world's wealthiest and poorest nations. His only clear exceptions were rapidly growing China and India. While correct, Dollar neglected to observe that China and India had received **exceptionally low** levels of per-capita and per-GDP foreign aid compared to the world's other poor countries (Gilles, *et al.*, 1987, p. 369). While Dollar saw the past lack of success of foreign-aid to poor countries, he displayed a Sheepdog-like blind-spot as regards the possible **perversity** of such aid.

The presumption that Dollar has surely sometimes thought about this possible perversity raises a second similarity between Old English Sheepdogs and Economists. Again because the eyes of a typical Old English Sheepdog are covered by fur, an outside observer has to rely on quite indirect evidence to determine what the dog is really thinking. Is the dog feeling aggressive or benevolent? The fact that Dollar, a leading World Bank Economist, is ignoring existing evidence on the perverse nature of foreign aid to the world's poorest countries is preliminary evidence that his underlying, doubtless subconscious, intentions are more self-serving than society-serving. Other such evidence exists.

Dollar is suggesting either advice-accompanying unconditional grants or a new variety of conditionality. But unconditional grants to very poor countries are a disaster. The leaders of such countries rationally pocket such grants and work to make their countries poorer in order to qualify for even larger grants in the future (Bauer and Yamey.) Moreover, increasing the profit to leadership in these countries increases the temptation to acquire leadership and thereby increases the extent of civil war and repression, the costs of which are substantially born by the intended beneficiaries of such "aid." The optimal capital stocks of such revolution-threatened "brutocracies" are exceptionally small (Thompson-Hickson, Chapter 5).

Dollar's new conditionality stems from his assertion that modern studies suggest the importance of institutions (including local institutional persistence and regional particularism) and financial assistance for constructing social overhead capital. However, even quantitatively oriented Development Economists writing twenty years ago largely shared the same view (*e.g.* Gilles, *et al.*). Moreover, although Dollar is appropriately negative concerning the loan-conditionality that has increasingly dominated the past two decades, he fails to convincingly rationalize his negative evaluation and what, if anything, establishment Economists have learned about economic institutions that would assure us that his conditionality would be substantially superior to existing conditionality. (For a price-theoretic analysis of the devastating character of existing conditionality, see Thompson-Hickson, pp. 82-88 and Chapter 5.) Has the development-economics establishment really learned anything of theoretical substance?

What makes Development Economists traditionally so difficult to understand is their failure to generate a Pareto-relevant explanation of what makes some economies so much richer than others. The market failure that Dollar, like most other, similarly experienced, Development Economists, emphasizes is "weak property rights." This apparently means high transaction (including property-rights-protection) costs. But then how is it that high-legal-cost countries like Britain and the U.S. have been the world's richest two countries over the past two centuries? In any case, such a theory, while perhaps relevant to legal reformers, would have no policy implications for economics. While it is common for Development Economists to recommend the public support of investment projects that would be profitable but for the existence of high transaction costs, a likely reason the unadvised government would avoid supporting such projects is that these transaction costs would probably remain high even if the project were supported by the government. Peculiarly absent from the standard theories of underdevelopment is a low-level laissez-faire equilibrium for a given, optimal, legal system, a Pareto-relevant underdevelopment trap that can only be eliminated with certain economic policies.

A second salient fact overlooked by Economists is the fact that virtually all of the world's wealthiest economies are private-property-constrained democracies. Understanding democracy as system of negotiation between conflicting special interest groups that generates mixed-economy compromises among these interest-groups, this has been true since the beginning of recorded history. Before Economists can plausibly claim to know how to improve upon the mixed-economy compromises of these societies, they must first understand the economic problems that these non-economist-run polities are solving. Doing so entails the introduction of complex externalities, monopolies, collective goods, protection costs, and transactions costs that simply do not exist in standard economic models. The relevant market imperfections must be identified, and integrated into economic theory, before Economists can honestly expect to contribute to the reform of less successful states.

The only obvious way to explain this historic professional blind-spot with respect to the systematically unmatched success of certain democracies is to acknowledge that Economists are basically substitutes for democracies in generating legislation and therefore would collectively make themselves appear superfluous if they systematically approved of democratic legislation.

In any case, the above pair of economic blind-spots are intimately related. Indeed, the laissez-faire underdevelopment traps overlooked in the first blind-spot can be systematically eliminated only by an **effective** democracy, a democracy whose legislatures are pragmatically responsive to special interests and whose bureaucracy is ethically dedicated to dutifully executing the state's apparently irrational legislation (Thompson-Hickson, Appendix A.1 and Chapter 3). That is, what eliminates underdevelopment traps and related market failures in a private property system is effective democracy. While Economists have been historically too narrowly self-interested to admit this theoretical and empirical fact, most outsiders have not been so entranced by economic ideology. Like an unfriendly Old English Sheepdog, it would pay us to reform and come to be appreciated for the truly beneficial services we are potentially able to provide our society.

REFERENCES

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