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ROUNDTABLE DISCUSSION

Development Strategies: The Roles of the State and the Private Sector

The roundtable discussion at the end of the conference sought to highlight the panelists' views on the roles of the state and the private sector in development. The panelists were Amartya Sen, professor of economics and philosophy at Harvard University; Nicholas Stern, professor of economics at the London School of Economics; Joseph Stiglitz, professor of economics at Stanford University; and Stanley Fischer (moderator), vice president, development economics and chief economist at the World Bank.

Amartya Sen

This is a good moment to look both at the connection between the public and private sectors and at the role that the public sector can actually play. To begin with, I would like to make some observations on the theme as stated for the roundtable "The Roles of the State and the Private Sector", but I would, after that, also like to raise a question about this way of seeing the problem.

We know that the private sector has various shortcomings in dealing with problems of the type discussed a lot in the literature: public goods; situations of strong externalities; possibly large inequalities in the distribution of incomes, achievements, and freedoms; and so forth. What is interesting to note in terms of this general theoretical background is that when one looks at different countries with different types and extents of public sector activism, one finds that some countries have benefited considerably from such activism. This is important to mention because of the failures of public-sector-oriented economies, especially in Eastern Europe, which have been so widely discussed recently.

One way of presenting the problem is this: if you took all the developing countries and looked at performance measures of what they had achieved over a certain period—not just in terms of growth in gross national product (GNP) but increasing living standards, say, increasing life expectancy—the results would show a very peculiar mixture of performance. In our recent book, Jean Drèze and I used the criterion of under-five mortality (taking note of both infant and

The panelists' comments, taped at the conference, have been reviewed by them for publication.

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child mortality) and looked at the percentage reduction brought about between 1960 and 1985 (Drèze and Sen 1989). We found that the group of top ten countries in this ranking includes some in which the private sector has been immensely powerful and a major engine of expansion, raising GNP per head very fast, but where much resources and efforts have been put into public health and public education. However, the group also includes some that have remained poor in terms of GNP, but that have benefited significantly, especially in health and education, from the public sector. The reduction in child mortality we are talking about, ranging from 71 to 83 percent, is dramatic in this period.

Of the top ten countries, there are five in each of these subgroups. On the growth-utilization side are Hong Kong, the Republic of Korea, Kuwait, Singapore, and the United Arab Emirates. On the pure public support side are China, Costa Rica, Cuba, Jamaica, and—rather interestingly—Chile. Chile is in that category because although its growth rate has been low, its policy interventions have continued to be very strong, particularly in health and infant care, a fact not widely known.

Incidentally, the latter group with strong public sector interventions would have also included Sri Lanka if we had started not at 1960 but earlier, because the health transition in Sri Lanka took place in the 1940s and 1950s, when public health arrangements were dramatically expanded and when the system of free and subsidized rice distribution was initiated. Between 1940 and 1960 Sri Lanka's death rate went down from 20.6 percent to 8.6 percent. A region that would have also been included in the second subgroup if it had been a country is Kerala, but being a state in India, it was excluded.

So, in terms of at least some of the criteria to which we might attach importance, health and education particularly, the public sector's performance has been significant. This is not only the case in China, Costa Rica, Cuba, and so on; it is also the case in some of the countries with active private sectors and with high growth of disposable incomes. Nearly all of these countries have devoted a tremendous amount of growth-generated resources to the public sector for health, education, and social security. The positive role of using growth-generated resources for skillful exposition of the public sector linkage is brought up very sharply if you contrast the experience of the countries with this linkage with the experience of some other countries that were already rich and have become richer in this period but that have neglected this linkage. The contrast between, say, Korea and Brazil, and between Kuwait and Oman, is quite striking. The point is that even for the cases of high growth performance coupled with substantial private sector success, one sees the fruitfulness of using growth-generated returns as a means for expanding social security and the quality of life through the public sector.

China presents a very interesting set of contrasting experiences. During the pre-reform period between the Revolution in the late 1940s and the economic reforms of 1979, the Chinese experienced very little expansion of food output

per head, and also very moderate increase in GNP per head (not according to World Bank estimates, but we know that there are tremendous problems with those estimates). However, in contrast to the low growth of GNP per capita, the reduction in mortality was very high. Life expectancy in China went from being close to forty years to the high sixties in that period.

In contrast, in the post-reform period, a time during which economic reforms and incentives had a dramatic effect on the expansion of agricultural and food output (agricultural output nearly doubled between 1979 and 1986), the fast expansion of life expectancy was halted. The Chinese official statistics indicate that mortality reached a floor in 1978–79 and has been *higher* every year since then. Now, I think, the Chinese mortality statistics are questionable. There is the problem of the aging of the population, and there is also the problem of increased coverage. But even after these adjustments are made, and even if one does not accept some of the early calculations that indicated that life expectancy had actually fallen substantially since the reforms, there is no doubt at all that the sharp decline in mortality has been halted and there has been a considerable decline in public health services.

The reasons for this are not altogether unknown to standard economic theory. One is dealing with the problem of financing of public goods. Communal agriculture did little for agriculture, but it did a lot for public health, for reasons that are not surprising. Conversely, the remedy that was so successful in raising agricultural output—to wit, privatization—did not work so well when money for public health became scarce and when patients had to pay individually for medical care, when social medical insurance coverage (largely related to communal agriculture), which at one stage covered 85 percent of the rural work force, fell to 15 percent. Perhaps better coordination between the public and private sectors could have made a difference.

On the coordination issue, one of the things that Drèze and I show in our book is the very effective famine relief the public sector can provide in conjunction with the private sector. The public sector, through programs such as cash for work, can do this by creating employment, recreating entitlements lost as a result of the disaster, and thereby generating income. This can be effectively combined with use of private food trade in the affected region. This combination of public-sector-based income generation and private-sector-based food trade (provided there is also a credible threat of a public sector intervention to prevent supply manipulation of the market) can be very effective. Its effectiveness contrasts sharply either with the public sector taking over famine relief completely (as has often been tried, without much efficiency, especially in Sub-Saharan Africa) or with leaving famine relief entirely to private initiative (which has been also tried, with unmitigated failure in famines across the world).

This brings me to the concern I expressed at the beginning of my remarks about seeing the problem as one of the relationship between the private sector and the state. My concern is that the view suggested by the title of this discus-

sion, "The Roles of the State and the Private Sector," leaves out a major participant, namely the public. This worry is not a fuddy-duddy, romantic one. The public can play an important political role in putting pressure on state policy, and on the private sector—directly or through state policy.

This is, of course, partly related to the issue of democracy. The connection is most immediate in the case of famine and famine prevention. Major famines have taken place in market economies and in nonmarket socialist economies, but not in any country with a democratic system, with opposition parties, and with a relatively free press. This is a remarkable fact. Famines are, obviously, terrible for the people who suffer or die, but they are often not very expensive for nondemocratic governments, which can survive famines. This applies both to nondemocratic left-wing governments supported by the Soviet Union and to nondemocratic right-wing governments supported by the West; many examples of each can be given from Sub-Saharan Africa.

It seems to me that the absence of democracy and public pressure is at the root of many policy failures in development strategy. The connections are not always obvious, nor always strong or immediate. But some links can be seen. Countries such as Botswana and Zimbabwe, which have done well in preventing famines, have a relatively better record in terms of having opposition parties, stronger media, and public opinion pressure. The picture for India is fairly clear, and the contrast between the pre- and post-Independence India is very sharp indeed. There were famines in India right up to Independence; the last one was in 1944—the so-called great Bengal famine. There has been no famine in India since Independence. This is obviously partly due to agricultural achievements, but to a great extent, it is because democracy makes famines much more expensive for governments. A government that can be criticized by opposition parties and by the media and that has to seek reelection by the people cannot afford to have a famine. It has to take quick action to prevent it.

The contrast between India and China is also quite sharp with respect to famines. China's economic record is in many ways very much better than India's. Nevertheless, the famine that took place in China between 1958 and 1961, with various estimates of the death toll ranging from 23 to 30 million, makes it arguably the largest recorded famine in history. It would be very hard for such a famine to take place in any country where the government has to face elections, and the newspapers are free. Chinese newspapers did not criticize the government—indeed did not even cover the disaster. The government maintained, without a basic revision, the same disastrous policies through the three years of the famine.

Public pressure and a free press have a creative role to play, not just in preventing major disasters such as famines but also in making social security programs less fragile. If China had had opposition parties and free newspapers, the abrupt and widespread withdrawal of social medical insurance in the rural areas after the economic reforms of 1979 would not have been that easy to put through.

If I had the time, I would go on to argue that some of the criticisms of the "softness" of the state, and the corollary view (characteristic of early writings on development economics) that the "harder" the state the more effective it must be, are dead wrong. Quite often what appears as softness is the responsiveness of the state to the public asserting itself and demanding that the state should take heed of the public's welfare. That need be no bad thing.

NICHOLAS STERN

I will focus on three things. The first is the meaning of "public" and "private" in today's discussion. The second concerns the reasons for state action. And finally, I will look at the consequences of state action. I will argue that an examination of the reasons and consequences gives us strong pointers as to where and when the state should be involved.

First, an insistence on discussing the meaning of public and private is not just the act of the evasive academic stalling for time who says, "It all depends on what you mean." The definitions really do matter. Different aspects of "publicness" and "privateness" have different economic implications. To focus on just some of these aspects can divert us from the key issues for economic performance and social welfare.

Ownership is typically seen as the defining characteristic of public and private, but ownership is not, by itself, uniquely defined. Let me briefly list four of the many aspects of ownership: the right to manage for certain purposes; the right to income arising from the use of property; the power to transfer property; and the right to exclude others. One could go on with this list, but I want to make the point that measuring ownership in order to say what we mean by public and private is not as simple as it sounds.

Let me illustrate why these things matter. I will focus on the first and second definitions I mentioned—the right to manage for certain purposes and the right to income arising from the use of the property. In passing, however, let me note that the right to exclude others is not always a feature of private property. British farmers, for example, do not have the right to stop people entering their farms. Similarly, for the public sector, the government does not have the right to exclude anyone from public roads, except under very special circumstances.

So what about the right to manage? I will give three examples that underline the importance of the right to manage in the performance of firms and how variations in these management rights can influence firm behavior. First, take firms in socialist economies where output planning is changed to a form of planning that gives the firm some discretion. That is exactly what happened in the mid-1980s in China. It was not a change in ownership, in the conventional sense of selling the firm or changing the rights to income in any major way. It was a change in the scope of management rights, and the firms that now had greater discretion in managing their own activities made a significant leap in productivity.

One cannot, of course, completely separate the right to manage from the right to residual income, because changes in the right to manage need some accompanying incentives. Managers will not become more efficient unless there is also some incentive for them to do so. The incentives involved, however, can be quite a small proportion of total profits.

The second example of the right to manage—or the lack thereof—is the borrowing of public-sector corporations, which is treated differently in different countries. In the United Kingdom, when we still had a substantial public sector, there were considerable restrictions on the borrowing of public firms. The restrictions arose because the borrowing of these corporations was counted in the public sector's overall borrowing requirement, and the government focused on the public-sector borrowing requirement as an instrument of control.

One could argue that for the British railway and telecommunications systems prior to privatization, these limits on their right to manage really had to do with a peculiar accounting convention, and the focus on a particular overall number. And yet they greatly damaged the infrastructure of the United Kingdom. In contrast, borrowing by public corporations in France is not counted in the same way. Borrowing by Electricité de France is not part of public-sector borrowing, but that by the electricity industry in the United Kingdom is, at least until its planned privatization goes through.

So what we have then is an administrative control on the right to manage quite dramatically affecting economic performance. In many ways, one can argue that there was no need to privatize these corporations to remove the controls.

The last example concerning the right to manage I would like to give is from India, where Wade's analysis of the control of irrigation at the village level in Andhra Pradesh shows how communal management could produce quite positive and efficient results in allocating water, even though the irrigation system was publicly owned at a much higher level (Wade 1988).

These examples—the relaxation of output planning, public-firm borrowing requirements, and communal control of irrigation—show that the right to manage can vary a great deal within the public sector even without a change of ownership, and these different rights can make a big difference to performance.

Let me now turn to the meaning of public ownership and the right to income as defining what is public. This perspective of the right to income can show us that public ownership in some ways is very much more extensive than it might appear at first sight. A 50 percent profits tax with a full loss offset provision is equivalent to the government taking a 50 percent share in the firm. Hence, taxation of this kind is akin to public ownership. In fact, it may be that when the government underwrites firms it may have to bear 100 percent of the losses even though it gets only 50 percent of the profits.

The upshot of all this is that we have to look at public ownership very closely. It has many different dimensions, and looseness in definitions can divert us from

some of the more important aspects. Later on, I am going to emphasize the importance of competition, because the history of British privatization suggests that it is not so much public or private ownership that matters—it is the competitive environment in which the firm operates that really counts.

I now come to the second issue I want to focus on: the reasons for state action. The first reason is from standard welfare economics, where we point to market failure. Among the reasons for government intervention are externalities and public goods, and missing markets, in addition to conditions leading to the violation of perfectly competitive behavior such as imperfect information, increasing returns, and entry barriers. These reasons, we know, have to be set against the possibilities of government failure.

The second reason for state action concerns poverty and deprivation, to which Amartya Sen referred. Perceived responsibility to alleviate poverty can provide strong grounds for state action involving social security.

The third reason for government intervention concerns rights. Many, including myself, would argue that individuals, as part of their citizenship or involvement in society, also have certain basic rights, including, among others, certain aspects of education and health. Some others—though I am not sure about this one—extend the notion to the right to housing as well. Many discussions of provision for the disabled turn on the notion that it is wrong to so organize affairs that the disabled are excluded from the "right to participate" in society and economy. Questions of basic rights and equality of opportunity again point to government action.

Fourth, we have what you might call paternalism, where individual preferences are overridden by the government. Drugs are clearly an important example, when an individual's preferences for drugs are overridden. But I also think compulsory pension schemes are another example in which the government acts to reinforce the "higher" self against the "lower" self.

Last, there is reason for government action arising out of accepting responsibility for future generations, which current generations, left by themselves, might not take. Concerns such as forestalling global warming, conserving the rain forests, and protecting endangered species fall in this category.

We now come to the consequences of state action. A popular view is that when governments intervene (through quotas, prohibitions, restrictions, and the like), all you get is rent-seeking and unproductive activities. The costs may be very large, in contrast to those associated with traditional calculations of deadweight losses (usually in the context of taxation). Rent-seeking is no doubt important, but from an empirical point of view, it is very hard to know what the costs of rent-seeking are. Most estimates of rent-seeking measure the size of rents, and then assert that the cost of rent-seeking, in terms of the resources used up in competitive markets, is equal to the size of rents. This rests on the rather dubious assumption that rents are competed for in perfect markets. But in fact the markets for rent are very clearly not competitive. The rents earned by the

Marcoses in the Philippines clearly were not rents for which there was open competition.

Government actions may or may not be beneficial. I want to focus on a few examples that show how economic theory and policy experience can combine to help us in understanding when governments should intervene and what limits government action.

The first example—one I first looked at more than twenty years ago—is the Kenya Tea Development Authority (a successor to crop development authorities promoted under the colonial government). Smallholders grew tea, the government organized the activity, private factories processed the tea, and it was sold in London. Quality control was exercised through the management of marketing outlets. The government in this particular project took responsibility for roads, for agricultural extension, for information and teaching of the peasant tea growers, and for coordination. These were all areas where economic theory tells us that there are good reasons for governments to act—in areas where markets might fail—and my cost-benefit analysis of the programs in the late 1960s was in line with the common judgment that the initiative was very successful.

The second example of state action and its consequences I want to describe concerns social security in Maharashtra State in India. There, the Employment Guarantee Scheme has been quite successful in protecting the unemployed against destitution. One of the central reasons the scheme has worked is that it was "incentive compatible," and participants were self-selected. In order to receive the payment, one has to present oneself for employment at not very attractive wages. This aspect helps overcome the problem of adverse selection. In contrast, other poverty alleviation schemes in India, such as the Integrated Rural Development Programme, that have tried to make subsidized loans to people on the basis of their incomes—whose measurement is easily manipulated—have performed much less well.

My third example has to do with privatizations in the United Kingdom. The most successful privatization in the United Kingdom, in terms of efficiency and performance, involved commercial areas in which publicly owned firms had to compete in the marketplace to get customers. I am speaking of entities such as Cable and Wireless, Jaguar, and British Aerospace. Less successful in terms of performance and more troublesome in terms of regulation has been the privatization of natural monopolies—British Gas, British Telecom, and, more recently, water and the soon-to-be privatized electricity industries. The primary lesson here then is that competition, rather than who actually receives the profits, is the more important factor in performance.

Fourth, we may draw attention to the very large experience of development projects in the World Bank over the last decades and their history and documentation, particularly by the Operations Evaluation Department. Roads and irrigation, classic examples of infrastructure, seem to have been rather more suc-

cessful than other areas. I know that analysis of these and other development projects is well under way, and it is something those of us outside should greatly encourage and watch with enthusiasm.

Fifth, I would note that a number of authors over the last two decades have attempted to provide a long-run and comparative perspective of growth performance—in a sense, to set out in broad terms the lessons of history regarding the appropriate degree of intervention (see, for example, Chenery, Robinson, and Syrquin 1986; Morris and Adelman 1989; Reynolds 1983). In general, the analysts avoid asserting that there is a unique best strategy. Some countries, such as China and Korea, have performed well with a great deal of government intervention; others, such as Hong Kong, seem to have flourished with a minimum of government interference. Sen has argued strongly here and elsewhere that democracy may be of great importance in preventing famine, but it would be hard to be confident from comparative history that democracy is good for growth. Has it been democracy that has propelled Hong Kong and Singapore? The evidence appears to be ambiguous.

Where does all this lead us? We should not delude ourselves that transition is easy, or indeed that the same formula is appropriate to all countries. A careful and creative economic analysis of potential reforms should leave us a number of options and not a single economic blueprint.

Nonetheless, I would argue that the examples I have cited illustrate a conjunction between theory and experience and give us fairly direct answers about when governments ought to intervene. From the point of view of income distribution and protection, governments ought to be active in social security. From the point of view of rights, they ought to be active in education and health. From the point of view of market failure, they ought to be active in infrastructure, in roads, power, and so on. Where governments should not be active—because none of these arguments apply—is in the private production of hair pins, motorcycles, motor cars, and the like.

Let me conclude with some speculation on how the relative roles of public and private sectors might move as development progresses. In poor and backward economies, market failures may be more severe, but the same is also true of government failure. How do these considerations balance? I would suggest, notwithstanding the weakness of management and the scarcity of resources in poor countries, that there are certain crucial activities for which the government should take responsibility. In poor economies, infrastructure, health services, and education are usually weak. Here, surely, are areas where government can act and be assisted with resources and know-how from wealthier countries and international institutions.

Governments obviously need a tax system to finance their activities. That is a subject for another day, but I would just like to note that developing countries do seem to be learning quite a lot of lessons about taxation, and it is impressive how much in fact they do collect.

Joseph Stiglitz

The burden of my remarks is to deal with what economic science has to say about the appropriate roles of the state and the private sector. It is an issue on which most economists will have a strong opinion. But if you ask a taxicab driver, he will also give you an opinion. The question is, should our opinions as economists be listened to more carefully than those of the taxicab driver?

One can attempt to address the question on grounds of theory and on grounds of evidence. I am basically a theorist, so I began by asking the question: do we have any theorems that provide insights into the question? Well, there are two old theorems that speak to the issue, and two new theorems.

One of the old theorems—the Lange-Lerner-Taylor theorem—says that market socialist economies and private capitalist economies are equivalent. Yet anybody who has visited a socialist economy—even people who claim to be market socialists—would express some skepticism about the theorem. Of course, a theorem only proves that certain conclusions are true based on some given assumptions. The question is, do the assumptions underlying this theorem describe either the market socialist economies or the capitalist economies? And I think there is a growing consensus that neither part of the theorem is good.

The other old set of theorems are the fundamental theorems of welfare economics. These underlie the market-failure approach that motivated Stern's remarks about how to define the role of government. The theorem says that the markets are efficient, except for certain well-defined market failures, such as externalities, or the public provision of infrastructure. The view has been extensively developed over the past two decades, on the basis of this theorem, that the government should intervene in these well-defined areas and keep out of everything else.

The two new theorems I want to talk about address more current issues. The first tries to explore two of the hidden assumptions in the earlier fundamental theorems of welfare economics. In particular, the new theorem asks: if we have incomplete risk or futures markets and we have imperfect information—both of which we all agree we do—what can we then say about the efficiency of market economies? The answer—in general—is that market economies are essentially never constrained Pareto-efficient.

The theorem is interesting because it has taken away the intellectual foundations for the belief in the efficiency of a market economy. The old welfare theorem said that government, no matter how well organized, no matter how competent, could not do any better than the market. And if that is the case, then we do not have to inquire very much into the nature of government. In contrast, this theorem says that in the presence of imperfect information, incomplete risk markets, and incomplete futures markets, there is the potential for government intervention. However, the theorem does not say what governments must do to realize this potential. We have to then inquire into whether that potential can be realized.

The second new theorem has to do with privatization. Much of the earlier literature did not address the central issue which has become the focus of discussion in the last five years. The kinds of interventions that were often talked about in the earlier literature, say, in the context of externalities, do not address the question of whether there should be government production. They only require some form of government intervention, often in the form of taxes or subsidies—that is, Pigouvian interventions of a very limited kind.

The issue that has been more recently under debate is whether the government should be involved in production. Or should government leave production—that is, privatize? The new theorem, which I refer to as the fundamental privatization theorem, does address these issues. Like the welfare theorems, it says that private production can emulate public production, that is ideal public production, only under highly restrictive conditions. So that, in general, the two are not equivalent. This provides a weak intellectual foundation for understanding the precise roles of the government and the private sector. What it does say is that we do not have any confidence necessarily that markets are efficient, that there is a potential scope for government intervention, but it is a fairly diffuse and ill-defined role until we fill out the details.

I now come to the empirical evidence on the roles of the state and the private sector. Here economists, for the most part, specialize in anecdotal evidence and tend to be fairly selective, depending on which side they are on.

There are many examples of incompetent government enterprises, and those who criticize government have a rich set to draw upon to verify their prejudices. Yet there are also many successful government enterprises. I think there is a general consensus that many of the French enterprises have been very successful. Many people cite some examples in Singapore. Studies show that there is no significant difference between the efficiency of the Canadian National Railroad and the Canadian Pacific Railroad.

So, if one is not quite so selective, then one can find examples on both sides of the issue, and we need to inquire in more detail what accounts for the success or failure of particular government programs. At the same time, I should also emphasize that we have a number of instances of incompetent private corporations. In fact, some of the incentive issues extensively discussed in the context of public sector activities are almost as important for the private sector. In large U.S. corporations there is a separation of ownership and control. However, the takeovers in recent years have graphically demonstrated the ability of managers to walk off with millions of dollars of their companies' resources. For example, the management of RJR Nabisco in the recent takeover walked off with over a hundred million dollars of bonuses for their efforts in getting rid of the company. Also, an audit showed that whenever the president of the company went on a trip, he was accompanied by a person called G. Shepherd on a separate plane. The auditors looked through the company's organization chart, but could not find any G. Shepherd. Finally, they found out it was the president's German Shepherd, who bit people and "needed" to travel in a separate airplane! I do not

mean to prove anything with this story, but it does make the point that anecdotes can also be produced on either side.

The only other piece of anecdotal evidence is that governments, besides their role in the provision of infrastructure, have played an important role in almost all successful economic development efforts. So the question is not whether the government ought to play a role, but to define more precisely the appropriate role.

Moving from these fairly general issues to more specific ones, I want to turn to financial markets and entrepreneurship. Well-functioning financial markets are now recognized to be central in any development effort, for which the allocation of capital is a vital function. This function is not done well at a centralized level or with a planning mechanism, because the issue is not so much the choice of sectors that ought to get funds, but the particular project and the particular managers—involving complex institutional questions—that should be selected. In the United States we know what happens if you do not have well-functioning financial markets—savings and loans institutions have misallocated an amount of capital equal to somewhere between a quarter and a half of the U.S. economy's total annual saving. And that is a lot of money to be squandered.

The fact that the U.S. economy has not done such a good job with its financial markets suggests that other countries—particularly developing ones—are going to have a hard time as well in the development of their financial markets. The recent literature on this has focused on the pervasiveness of information problems in financial markets. In addition, these markets are characterized by credit rationing and by equity rationing, and this has important effects both on resource allocation and macroeconomic behavior. I should point out that the fact that there are such problems in the private financial sector does not necessarily mean that governments can do any better. We are now increasingly aware that we have to accompany an analysis of market failure with an analysis of government failure.

Stern referred to the recent arguments about government activities generating rent-seeking behavior, which would completely absorb all the rents. I agree with him that this is not a general result and only holds under certain special assumptions. Under more general assumptions, rent-seeking does take place, but will not necessarily dissipate all the "rectangles"—the areas between the demand and supply curves that arise, say, with government-imposed trade restrictions.

Governments face many of the same information problems that the private sector faces, sometimes more acutely, and sometimes less acutely. We are increasingly trying to define more precisely the advantages and disadvantages of government relative to the private sector. But it is only detailed comparative analysis that will lead us to a sense of the appropriate assignment of responsibility between the public and the private sector.

Let me also emphasize a point that Stern raised, which is that the issue should not just be viewed as a contrast between the private sector and the government. It really is a question of the whole complex of relationships among market,

nonmarket, government and state, and voluntary institutions, and the particular forms that the government intervention takes.

My concluding comment on the issue being discussed is that the appropriate analysis should not be based just on ideology, should take into account the institutions, the nature of government, and the nature of the private sector in particular countries. This needs to be done against the background of the emerging general principles about circumstances that are more conducive to efficiency in either the public or the private sector. Among these conditions are the importance of having appropriate incentive structures—including subjecting markets and firms to competition—either in the private or the public sector. I also agree with Sen's earlier comment that these conditions also should be embedded into democratic societies that would then provide checks and balances that are important to a successful development strategy.

Floor Discussion

A participant asked the panelists whether the general principles they had enunciated about the roles of the private and public sectors should vary across different stages of development. What does the historical evidence tell us about it?

Another participant expressed disappointment at the impression Stiglitz had given that *all* economists have for empirical evidence are anecdotes, and one can choose one's own anecdotes to make one's case. The participant had expected the speakers to go beyond the well-known welfare theorems and draw on history, which over the last forty years or so offers a wide selection of development strategies and performance.

A World Bank participant said that the stark juxtaposition of the private sector and the public sector overlooked the role of private voluntary organizations and the nongovernmental organizations; within the public sector itself, it also ignored various levels, such as national, state, and local governments, and community organizations. Another Bank participant noted that apart from the question of ownership, one element missing from the discussion was the question of who sets the rules of the game, and the public sector had to be involved in that.

Stiglitz responded that the problem with history is that different people read it differently. Some general principles, however, can be gleaned from the historical record. First, there is an important role for the government in setting rules for the private sector, including incentives, private property laws, and contract law. Second, competition is more important than the private-public division; giving a private firm a monopoly is not likely to improve efficiency as much as pitting a public enterprise against an open economy and subjecting it to competition. The general implication from reading history is that ownership is not as important as the environment in which a firm operates.

On a related issue, Stiglitz said there was at one time a concern that in the

early stages of development the state would have to intervene to promote entrepreneurship, since it would not otherwise be forthcoming. It is now recognized that innovation within state enterprises requires entrepreneurship just as much as it does in the private sector. One of the problems with state enterprises is that they often are unable to provide adequate incentives for entrepreneurship and innovation.

Sen said that he agreed with Stiglitz that what appears, at one stage, to be a hard reading of the facts often looks different when one looks back. For example, in the mid-1950s, the Soviet Union's high growth rate impressed economists. Sen cited Wiles as saying that "In the Soviet economy there are, as it were, always too few hairbrushes and too many nailbrushes in view of the resources available, while in a 'capitalist' economy this proportion is always more nearly right. But the production of both these articles is growing at about 10 percent per annum in the USSR and about 2 percent per annum in the 'capitalist' countries. In the end the Soviet citizen will be supplied better even with hairbrushes" (Wiles 1962, p. 217; orginally stated by Wiles in *Oxford Economic Papers*, October 1953, pp. 315–16). Sen noted that such a comment seems extraordinary now, but it did not then. So although he agreed with the participant who had asked the question about the lessons of history, he felt that one needed to be cautious. One needs theory and reasoning to give depth to the brute observation of facts.

Commenting on Stiglitz's presentation, Sen said that Stiglitz had drawn a distinction between information constraints and incentive constraints, and focused on the former. Sen felt that while both the issues are important, the incentives problem was the more serious of the two in looking at the performance of the public sector. He said that the Lange-Lerner-Taylor theorem also focused on the information issue—whether market socialism could emulate the information-generating aspects of a market economy. However, the problem with market socialism is not so much with signals but with more incentives and entrepreneurship.

Finally, Sen contrasted the need to emphasize political as well as economic rights. Stern had focused mainly on economic rights, but this can be supplemented. Sen reiterated that the political rights were important both in themselves and in terms of their consequences, in giving those in authority appropriate incentives to be concerned with the well-being and the misery of the people.

Responding to the question about how the role of the state should change in the course of development, Stern said that when countries are poor and disorganized, it is possible to argue that the problems of market failure, as well as the problems of government failure, are more severe. This made the question difficult to answer. However, his own judgment was that in very poor countries the argument for a more active state is stronger than in richer countries. He pointed to four reasons for this: first, the state needs to be more active in providing infrastructure, such as roads; second, the state needs to help in the learning process and in accumulating knowledge and technology; third, the state has a

possible role in fostering capital markets; and fourth, the problems of economic and physical vulnerability are especially severe.

On the question about the lessons of history, Stern said that there is no single route to rapid growth. Most people who have looked at the question in historical perspective, and without prejudice, have suggested that there are several ways to grow. The comparative growth experience does not point unambiguously to the superiority of certain development strategies. Stern noted that the one single most important explanatory variable indicated by Reynolds in explaining long-term growth (extending over a hundred years) was the administrative competence of the government (Reynolds 1983). Of course, that still leaves the question of what is to be done when such competence is weak.

Fischer (chair) then thanked all the panelists and other conference participants. He noted that the purpose of these conferences was to open up communication between the World Bank and the academic and policy communities, and that the conference had highlighted some stimulating perspectives that varied from the standard thinking in the Bank. Fischer suggested that among the many things that the conference had raised, Sen's emphasis on the role of democracy deserves a great deal of thought, particularly on the difficult question of how it might affect the Bank's operations.

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