Comment on "Consensus Building, Knowledge, and Conditionality," by Paul Collier, and "Development Strategies for the 21st Century," by Dani Rodrik

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In these remarks I propose that development strategies for the 21st century cannot continue to overlook the middle class. I begin with comments linking global governance to a new style of development assistance. This new style, of which Paul Collier and Dani Rodrik are leading proponents, is based on a revisionist view of the fundamental development challenge. This revisionist view sees homegrown institutions as the scarce resource most critical to countries' development success in a global market. In the advanced economies with democratic systems it is the middle class that supports, and is supported by, these homegrown, market-sustaining institutions. But who in fact is (or could be) the middle class in developing countries? I provide some information on middle-income households in developing countries and suggest some implications for development policy.

Global Governance and Imperfect Representation

The demonstrations in Washington, D.C., during the April 2000 meetings of the International Monetary Fund (IMF) and the World Bank were fundamentally about global governance. They reminded us that the Bretton Woods and other international financial institutions are caught in a squeeze. On one side are those who insist they become supranational vehicles for the good and the just—be it labor standards, a cleaner environment, or uncorrupted and more transparent governments. This camp includes people who would have these global institutions become the major force for more efficient and stable global markets—"making the world safe for capital flows" is Rodrik's apt characterization—for example, by enforcing disclosure of national financial and macroeconomic indicators. The demonstrators and IMF management are on the same side of this question. On the other side are Collier, Rodrik, and former World Bank Chief Economist Joseph Stiglitz (1998), who decry the leverage of these institutions over policy decisions in independent nations, the breakdown of national auton-

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omy implied by their leverage, and their lack of adequate accountability to the citizens of countries affected by their decisions.

The IMF and the World Bank are global institutions with inevitably imperfect representation. Borrowing member governments most affected by the institutions' policies have limited voice. And many member governments do not adequately represent the interests of their own citizens. (Even in mature democracies citizens cannot be represented well on any specific issue.) Transparency, disclosure, and the involvement and pressures of civil society groups in member countries are partial—but only partial—solutions to these problems of imperfect representation.

Collier and Rodrik are leading proponents of new thinking about the business of development assistance *given* this system in which power and money are poorly aligned with representation of and accountability to affected parties. Both assume as a starting point that development assistance will be more effective where it eschews policy leverage ("conditionality") and instead concentrates on supporting national autonomy, local institutions, and the construction of a sustainable local consensus. This is because, as Rodrik argues, the key to past development success, once the worst macroeconomic imbalances were corrected, was not any particular recipe—certainly not a particular trade or industrial strategy, and not necessarily or primarily integration into world trade and capital markets. The key was effective and homegrown market-sustaining public institutions able to manage social conflicts, the constant demands of changing markets, and openness itself—and as Collier puts it, able to build and sustain a political consensus around policy reform.

But where will the market-sustaining institutions for managing change and building consensus come from? Beyond a hands-off tolerance for diversity and national autonomy, what principles might guide development assistance efforts to support such institutions? In the advanced Western economies the middle class has been the backbone of market-sustaining institutions. Might a comparable middle class play that role in developing countries?

The Middle Stratum in Developing Countries: New Opportunities and New Anxieties

The development literature and economists in general have been virtually silent on the middle class.[1] Economists have no simple, cross-societal, time-invariant definition of the middle class. But we can compare across countries the absolute and relative positions of the middle *stratum* (Nelson 2000)—for example, households with per capita income between 75 and 125 percent of the median—recognizing that in many countries this group may not fit our prior notion of the middle class.[2]

Middle-stratum households in developing countries are obviously much poorer in absolute terms than their middle-income counterparts in rich countries. They also tend to be poorer relative to their richer fellow citizens. Even in such emerging markets as Brazil and Poland, middle-stratum households have only about a tenth of the income (in purchasing power parity terms) of their counterparts in the United States. They are also much less educated. In Costa Rica adults in these households

have only about 6 years of education, and in Brazil about 4 years, compared with almost 13 years in the United States. The difference in education between the richest 5 percent of households and middle-income households is also much greater than that in the United States. Costa Rican adults in the richest households have an average of about 13 years of schooling—7 years more than adults in middle-income households. In the United States the difference is just 2 years: 15 years compared with 13.

Middle-income households in developing countries are not only closer to poverty (obviously, given their lower average income), but also probably more downwardly mobile. As many as 30 percent of nonpoor households in Indonesia and 22 percent in Peru are likely to become poor in the next three to six years, based on three-year fluctuations in reported per capita household expenditures. Of households in Peru sampled in 1990, almost half of those initially in the middle quintile of the income distribution had slipped down to the two lower quintiles by 1996; in the United States over a recent longer period, only a third of households suffered downward mobility.[3]

Surveys find the middle stratum in many developing countries an anxious and unhappy group—even where its members have prospered. For example, Graham and Pettinato (2000) show that many households in Peru and Russia that enjoyed rapid income growth in the past actually report that they are worse off, including in income terms. This may be the case in the richest and most advanced economies as well.

Anxiety is in part the outcome of the greater uncertainty of more market-driven economies operating in a more integrated and volatile global economy. In Latin America the return to growth in the 1990s brought modest income gains on average but more economic insecurity for middle-stratum households. Growth in private sector employment did not make up for the loss of secure jobs in government and in state-owned enterprises (except in Mexico and Central America, where growth in the *maquila* sector has been substantial). Even those who kept secure public sector jobs lost ground in terms of wage growth compared with private sector and informal sector workers, as in Peru (Birdsall, Graham, and Pettinato 2000, based on Saavedra 1998).

An increase in "unprotected" jobs with no written contract or social benefits for workers probably affected the middle stratum most because the truly poor never enjoyed protected jobs in the first place. Rodrik (1999) provides evidence suggesting that not only jobs, but wages became less secure as the volatility of the real average wage increased in the 1990s, driven mainly by macroeconomic shocks associated with more open capital markets.

In the formerly socialist economies of Europe and Central Asia middle-stratum households were hit hard by the transition. Even in Poland, where average annual per capita growth was positive between 1986 and 1995, the number of households in this category shrank more than 15 percent, and their income share shrank proportionately. In Hungary between 1991 and 1994, the number of households in this group shrank by 13 percent, and their income share by 17 percent.

In East Asia the financial crisis hit an emergent but still vulnerable middle-income group. Declining employment and falling wages in construction and manufacturing

hurt urban salaried workers, and heavy reliance on high interest rates to defend falling currencies hurt small business owners. Poor rural households and urban households in the low-productivity informal sector were obviously vulnerable to the economywide recessions. But a second group of people—those who might be called market-friendly urban strivers (Birdsall and Haggard 2000)—found themselves vulnerable for the first time as a result of the crisis. These people belong to households at or below incomes of about $5,000 (in purchasing power parity terms). In Indonesia this group is in the top 40 percent of the income distribution, in Thailand closer to the middle, and in the Republic of Korea closer to the bottom, although still mostly above the poverty line. Emergency measures were designed to provide a safety net for the poor but not particularly for this second group.

Easterlin (1995) has pointed out that people with low income care most about absolute gains in income, while people with higher income care more about their income relative to the incomes of those better off. If relative income matters, then where income and wealth are growing fastest for those at the top (for example, for the highly educated, as returns to education increase worldwide), households around the median are likely to suffer "middle-income stress." This will be especially true in developing countries, because of the bigger gaps in education between the rich and the middle class. Moreover, globalization of consumption standards might well be exacerbating such stress (Nike sales, for example, grew by 82 percent in Asia and 91 percent in Latin America in one year in the mid-1990s). Stress in middle-income households is low (but increasing) in Eastern Europe, and high (but declining) in Latin America (table 1).

The point is not to bemoan the effects of market reforms and globalization on the middle stratum or emerging middle class—many of those now in the middle stratum are there because market reforms generated new opportunities to escape poverty. Instead, it is to underline how little consideration we have given to what determines the size and income share of the middle stratum, how the middle stratum affects

Table 1. Size and Stress of the Middle Stratum in Selected Countries, Various Years, 1990s

Country	*Year*	*Population share of middle stratum (percent)*	*Income share middle stratum (percent)*	*Middle class stress*
Sweden	1995	38.0	31.6	1.43
United Kingdom	1995	33.1	26.0	2.07
United States	1999	24.2	17.6	2.67
Hungary	1994	43.8	35.0	1.77
Poland	1995	36.0	31.6	1.75
Slovak Republic	1992	58.2	54.6	1.30
Brazil	1996	20.7	9.6	7.32
Costa Rica	1997	24.5	17.6	2.99
Peru	1997	21.4	13.1	4.14

Note: The middle stratum is defined as households with per capita income between 75 and 125 percent of the median per capita income of all households. Middle-class stress is defined as the ratio of the median income of the households commanding 50 percent of total national income to the median income of all households.
Source: Birdsall, Graham, and Pettinato 2000.

market reforms and the integration of economies into global markets, and what role the members of this group play in the political and economic discourse and institutional underpinnings of the policies in their countries.

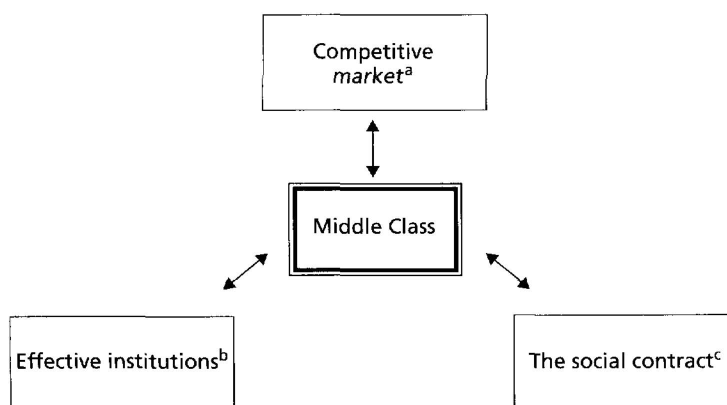
Nurturing a Market-Friendly Middle Class

Is a market-friendly middle class relevant to development policy and to the conduct of the development assistance business? What are the causes and consequences of a market-friendly middle class?

Some market reforms—privatization, tax reform, trade and financial sector liberalization—have not been easy on middle-income households. But a second round of institution-building reforms could greatly increase the stake of the emerging middle class in the market system. Better banking, better schools, property rights, the rule of law, contract enforcement, and a labor market organized around collective bargaining can all be thought of as contributing to a market-sustaining middle class. Reforms could be structured in a way to exploit this positive potential.

The process probably also works the other way around: an independent middle class will likely contribute to the healthy functioning of those same institutions (figure 1). Rodrik's emphasis on managing social conflict and Collier's on moving beyond conditionality to consensus are healthy reminders that some decisions in market economies are best made politically. Some economic reforms—relating to labor, pensions, and schools, for example—are more likely to be sustained if they emerge from a political process and not solely a technical analysis. An informed, educated

Figure 1. The Market-Friendly Middle Class



a. The focus of the first generation of economic reforms (stabilization, privatization, trade and financial sector liberalization, and so on).
b. The focus of the second generation of reforms (property rights, rule of law, judicial reform, education reform, and so on).
c. An outcome of representative and participatory democracy.

middle class can provide considerable institutional ballast in the volatile world of democratic politics. Indeed, Aristotle pointed out that the middle class is the natural ally of democratic institutions. The role of the middle class seems particularly important in settings where ethnic, racial, cultural, religious, and linguistic differences put a premium on effective and independent regulatory and judicial institutions.

Experience in the West suggests that the middle class is at the heart of any effective social contract. To be sustained politically, the social safety net programs built into a social contract must reflect the outcome of a political bargain that meets the needs of the middle class as well as the poor. In developing countries the poor might benefit more from a small portion of massive, middle-class-driven social insurance programs than from a large portion of targeted services; this has been the case in Europe and the United States (Nelson 2000, referring to Skocpol 1991; Goodin and LeGrand 1987). In open economies subject to global shocks, targeting the poor with special transfers may—if it implies a new burden on an insecure middle class—be less politically acceptable and sustainable than more comprehensive social insurance programs. A social contract, moreover, extends far beyond the narrow notion of the safety net; it includes the political freedoms and rights of participation governing a broad range of social and economic decisions. The ability to design and maintain this broad social contract may ultimately depend on the allegiance and intelligence of a stakeholding middle class.

It is true that the middle class is endogenous, an outcome of as well as an input to healthy institutions (see figure 1). My aim is not to propose an analytic framework or a new magic bullet for development, but simply to argue that we would do well to begin incorporating the idea of the middle class into our thinking about development. As Joe Stiglitz noted in his keynote address, ideas can be important in changing policy.

Finally, in focusing on the middle class we are not neglecting the poor. In the end, the sustainable growth on which poverty reduction depends requires adequate institutions. History tells us that the middle class is the bedrock of those institutions, at least in the democratic and open market systems to which so many people in the developing world justifiably aspire. Poverty reduction may ultimately require a market-friendly middle class.

Notes

1. A search of titles on the World Bank Group Web site yielded two hits on *middle class*—both referring to the same article by William Easterly—and "maximum number of hits/overload" (apparently implying hits beyond five digits) on *poverty*. A search covering titles and abstracts on the site "EconLit (1969–2000)" yielded 218 hits on *middle class* or *middle strata* and almost 10,000 on *poverty* or *poor*.

2. Data sources for this and all other statements about the middle stratum are cited in Birdsall, Graham, and Pettinato (2000).

3. For Indonesia, see Pritchett, Suryahadi, and Sumarto (2000), whose estimates are based on three-year fluctuations in reported per capita household expenditures. For Peru, see Birdsall, Graham, and Pettinato (2000) for data on the transition of households in the middle quintile in 1990 into the lower two quintiles in 1996.

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Comment on "Consensus Building, Knowledge, and Conditionality," by Paul Collier, and "Development Strategies for the 21st Century," by Dani Rodrik

François Bourguignon

Paul Collier and Dani Rodrik make concrete the renewal that seems to be taking place in the way we think about economic development, development policy, and the fundamental role of international aid and international development institutions. Interestingly, both echo the mounting worry about what globalization may imply for development and development policies in poor countries. Unlike the demonstrators whose slogans were heard in the Washington streets during the IMF and World Bank spring meetings, however, they contribute genuinely new ideas to the debate and point to promising directions for future action and research in development.

The message seems simple. Development thinking and development policy must include the role of institutions, and possibly changes in institutions, in the design and analysis of policy reforms. Largely because not enough attention was paid to institutions in the past, policy reforms have been less effective than expected, and since the 1970s many developing countries have grown more slowly than expected. For the same reason the so-called transition in the 1990s proved much harder in some countries than expected. And strict loan conditions requiring policy reforms without due consideration of existing institutions or the changes required in them made aid less effective than it could have been in relieving world poverty.

It is always encouraging to be told that although what was done or thought in the past was wrong, we now know why and can think and act correctly. Even though I share with Collier and Rodrik the conviction that institutions matter very much for development, however, we still need to define with some precision what this means for development policy and development analysis.

Rodrik's account of the development experience of the past two or three decades and what he believes were errors of appreciation by the international development community is both convincing and impressive. It is perfectly clear from this account that too much emphasis was put on specific policy reforms without due regard for the institutional framework in which those reforms had to be implemented. But it is much

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less clear what the fit between institutions and reforms should be or how institutions should be modified. Is it sufficient, for example, to say that democracy or social insurance institutions facilitate policy reforms? How is a society made more democratic, and how can it be persuaded to put social insurance institutions in place?

Collier's critique of the "aid for reform" doctrine since the mid-1970s is equally impressive and convincing. But his answer to the preceding questions may be less so. In particular, why would it be easier to build a consensus about the role of institutions and the effects of changing them than it was to build a consensus earlier about policy reforms?

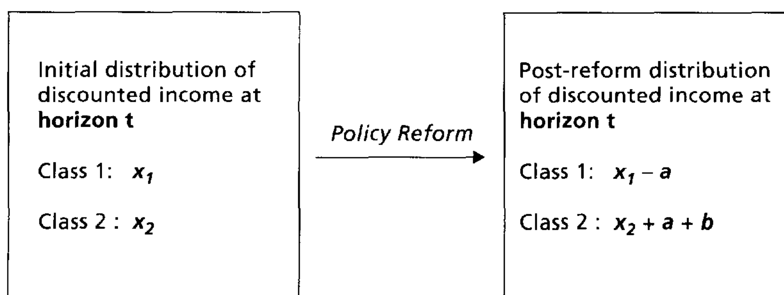
I have no better answer to these difficult questions. But I have learned that we can often make progress in this kind of debate by looking at the questions from a different angle or in a different framework. This is what I intend to do. I first try to formalize the issue of the fit between institutions and policy reform in a simple framework. I then look at the problem of institutional change that runs through the articles by Collier and Rodrik. Because it would be difficult to generalize in dealing with such difficult issues, I concentrate on institutions concerned with redistribution. We shall see, however, that this subject covers quite a bit of ground.

A simple model will prove useful for the discussion (figure 1). Assume that society comprises two classes of individuals, so that the state of the economy may be represented by two numbers that stand for the welfare levels of the classes. Welfare is defined over a given time horizon and takes into account all kinds of uncertainty. Without the reform the two numbers would be x_1 and x_2. With the reform—for example, lowering tariffs and nontariff barriers—the numbers would be $x_1 - a$ and $x_2 + a + b$, where a and b are numbers that represent differentiated changes in welfare.

Consider two cases. The first is the familiar Pareto dominance case, in which a is negative and $a + b$ is positive. Presumably this case is the less interesting one because the reform should raise no debate and should be undertaken with consensus. In the second case the overall gain is still b, but a is now positive. Thus, the gain is concentrated in the hands of class 2, while class 1 loses a.

If it were possible for class 2 to redistribute a or a little more to class 1, the reform would be undertaken because a "consensus" would be reached. This is the old com-

Figure 1. The Structure of Decisionmaking in Policy Reform



pensation principle used in welfare theory. The problem arises when this redistribution is impossible, either because the instruments are not available—for example, the redistribution authority has no way to unambiguously identify the people in class 1—or because the benefits of the reform will materialize only in the future and class 2 cannot effectively commit itself to redistributing them when they show up. There may also be a way to redistribute a from class 2 to class 1 but at a cost—for example, distortions—that exceeds b. Whether or not the reform is undertaken will then depend on political economy or public choice factors. Aid for reform could be one of those factors or simply an additional element in the political economy of the decision, as Collier explains very well.

This formalization is elementary, and the framework could be made more realistic in many ways. As simple as it is, however, it illustrates some important points in the debate on development policy and policy reforms:

- The values of a and b that are associated with the reform—or that may be functions of the characteristics of the reform—may be imperfectly known (the "knowledge" part of the title of Collier's article). Clearly, ambiguity about these values necessarily makes the decision about the policy reform more difficult. But some divergence in the estimates of a and b by economic experts, policymakers, and people in classes 1 and 2 may be justified. For example, the rates of time preference or risk aversion may differ across these agents. As mentioned, a may even be negative and $a + b$ positive—corresponding to a Pareto improvement—according to the objective function of international development institutions, but a may be positive, and thus a loss, from the point of view of class 1.
- The difference between aggregated and disaggregated benefits should be emphasized. To an external observer, the positive aggregate benefit b would seem to be a good argument for undertaking the reform. But if there is no way to compensate class 1 so that it can gain from the reform, the reform may be blocked, depending on the kind of public decision process used.
- Because of the difference between aggregated and disaggregated benefits, the effectiveness of existing redistribution channels appears to be a key factor in whether or not the "collectively profitable" reform will pass.

Trade liberalization is a good illustration of these points. Some literature emphasizes the problem of distributing the gains from trade (or from inflows of foreign capital) across the population. Some theoretical models show that where lump-sum transfers are impossible, the aggregate gains from trade might be dissipated in redistribution channels (Feenstra 1987; Lewis, Feenstra, and Ware 1989; Gabaix 1999; Spector 1999; Bourguignon and Verdier 2000).

Institutions are part of the preceding framework precisely because they often define the set of feasible redistributions or the public decision rule in the absence of a consensus about the reform. As an example, I consider an extremely simplified representation of the role of democracy and social insurance. The extent of democracy is certainly behind the political economy or public choice mechanism leading to acceptance or rejection of the reform. Whether the decision is made by a ruling elite

or involves a broader set of actors clearly matters for the outcome of the public decision process. But the extent of democracy may also determine the capacity to redistribute the gains from the reform. If a commitment is needed from one of the two classes to redistribute at some time in the future, or not to cease redistributing, it may be more easily enforced in a democratic system where reputation matters.

Another relevant institution is, of course, social insurance or, more generally, all the mechanisms that generate some automatic redistribution across income levels or occupational statuses, for example, from employed to unemployed.

Suppose, for instance, that some linear, progressive tax and benefit system is in place before the reform considered above, that all incomes are taxed at the marginal rate t, and that the proceeds are distributed equally to all citizens. If the two classes have the same demographic weight, the net gains $-a$ and $a + b$ become $-a(1 - t) + b/2$ and $(a + b)(1 - t) + tb/2$. So, the social insurance institution redistributes the total benefits from the reform more evenly across the population. This may be sufficient to ensure that both classes benefit.

What might the role of democracy be in this simple example? Assume now that the basic parameter t of the social insurance distribution is decided by a majority vote. It is well known that in this case the marginal rate of taxation increases with the level of inequality in society. This clearly reinforces the distribution of the benefits of the reform throughout the population and the probability that both classes will benefit.

Democracy and social insurance essentially ensure that the distribution of income or well-being will never diverge too much from that in some reference situation. Writing such institutions into the constitution may resolve distributional conflicts once and for all, and society may more easily and more systematically seize opportunities for aggregate enrichment. If these opportunities occur randomly, a society with these kinds of institutions should fare better in the long run than a society without them. But these institutions have costs in terms of economic efficiency, and these costs may have to be balanced against the benefit of more systematically seizing good opportunities for reform.

This leads to my last point, on how to analyze decisions about undertaking changes relating to such institutions. This kind of institutional reform is much harder than policy reform, and I am not sure general answers to this question are possible. Consider the case of a democratic society deciding whether to introduce social insurance that would cushion the effect of negative shocks on the income of the poor. Identifying who would lose and who would gain from this social insurance scheme requires imagining all possible shocks and events that might trigger the scheme, determining how much everyone would lose or gain in each of these circumstances, and assigning some kind of probability to the occurrence of each event. This clearly is a formidable task. Another problem, of course, is who should decide whether to make the institutional change. Paradoxical situations arise when the institutional change is precisely about the mode of public decisionmaking.

As Rodrik mentions, big institutional reforms tend to take place in exceptional conditions. Historically, such conditions were social conflicts or threats of such con-

flicts. The continental European social insurance system, for example, was born partly out of Bismarck's fear of rising socialism. But we clearly cannot wait for such circumstances for desirable institutional changes in developing countries. What should be done?The development community must make a strong general case for such reforms, with due recognition of the specific conditions in a country when proposing any institutional change. But the task of evaluating these changes from different perspectives in a society has to be undertaken one way or another. Rodrik and Collier appear to recommend that the international and national development communities make this evaluation their top priority.

I am happy to concur with them. However, we probably shall not complete this quest for a long time, and until we do, policy reforms within existing and possibly unsatisfactory institutions will remain on our agenda. We will need to improve our capacity to deal with them.

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Comment on "Development Strategies for the 21st Century," by Dani Rodrik

Fukunari Kimura

Japanese economists have claimed for some time that import substitution policies sometimes work well, that institutional diversity is important, that gradual policy reform is likely to be better than a "big bang," and that applying a single policy prescription to all countries can be dangerous. Dani Rodrik lucidly presents views along the same lines, and I am sure that many scholars in Japan and elsewhere would happily acknowledge this endorsement of their claims by a prominent mainstream economist.

Rodrik argues that market incentives are critical to economic development, that these market incentives need to be underpinned by strong public institutions, that market economies are compatible with a diverse range of institutional arrangements, and that the greater the fit between market-oriented reforms and preexisting institutional capabilities, the higher the probability of success. He claims that the "augmented Washington consensus" takes only the first two into account. He proposes that we develop a new paradigm that also takes care of the latter two.

Rodrik's article is intellectually provocative, and I agree with most of its claims about the relationship between markets and institutions. But I am concerned about throwing away the old paradigm before establishing a new one. Development is a very practical field. No matter how intellectually sincere, a notion that neglects its potential political economy implications will not necessarily bear good fruit in practice.

Take the Japanese experience with free trade. Trade theorists kept showing theoretical examples in which free trade was not optimal, even though we knew that free trade was "pretty good" in most cases. As a result, we were not very successful in convincing the public of the merits of free trade. This failure was due in part to our professional sincerity in exhibiting exceptional cases while not clearly presenting a rule of thumb. To guide policymakers, we need a benchmark model even if it does not always apply.

The issue discussed here has a different scope, of course, but the relationship between theory and practice is nevertheless similar. Because we always have to fight pressure from people who resist policy reform, we desperately need a simple, common, and

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seemingly objective guideline (rule of thumb). If we said, "Because institutions differ across countries, we must proceed case by case," we would provide excuses for avoiding policy reform. Such a statement might be intellectually honest but politically inadvisable in some parts of the world.

As Rodrik asserts, we have recently acquired a much better understanding of the complementarity between markets and the state, the importance of institutions, and the implications of institutional diversity. The question is how economists should deal with the institutional aspects of development. We now know that institutions are diversified for good reason and crucial to economic development. But we economists do not always know enough about institutions. So, what do we do? Should we discard all the old ways?

We do not have to lose all confidence in economics. Nor should we assume that only someday will we economists understand and be able to manipulate all development issues, including institutions. We must first do what we can do. Some issues are still straightforward, and our traditional paradigm can still provide a robust rule of thumb.

Rodrik acknowledges a strong confidence in the market. And there are still a number of basic policy issues that we can deal with using the traditional methods of economics. Although current economics cannot handle every detail of development policy, it can still provide general policy guidelines.

How can we learn from history? Rodrik claims that import substitution policies are not statistically associated with poor growth performance. But in future research we must digest the casual observation, record the possible economic causality, and specify when import substitution works well, when it does not, and when it does not matter. The traditional deductive approach can still be effective in drawing policy implications from history.

The same is true for international economic integration. The weak statistical association between economic integration and growth performance does not necessarily mean that economic integration is unimportant. There is still much room for analyzing the economic implications of open-door policies. We have learned a great deal from the Asian crisis, for example, about the implications of capital account liberalization.

As for Rodrik's market-sustaining public institutions, we have to reorganize issues by classifying them into what we can and cannot handle with traditional economics. Regulatory institutions can be handled to a great extent by traditional microeconomics. But it seems practical to deal with macroeconomic stabilization policies using an institutional approach, as Rodrik suggests, rather than rigorous microeconomic models. For social insurance institutions, setting the objective function is the key. It is still useful to separate efficiency issues from such social objectives as income distribution, as economists traditionally do to fight political pressure.

In sum, I agree that our improved understanding of the relationship between markets and institutions should encourage a substantial modification of our development strategies. But neither the traditional approach nor the augmented Washington consensus is useless or harmful, and neither should be immediately discarded. Many "simple" issues can still be handled using the traditional approach. And when we are reasonably confident, it is important to present a rule of thumb. We economists should neither underestimate nor overestimate our role in handling institutions. By considering the political economy implications of our work, we can still play a crucial role in economic development.