Market Failure and Policy Failure in Alleviating Urban Poverty

Bruce Herrick
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ABSTRACT

Suboptimal resource use causes urban poverty. It can be traced both to market failures and to policy failures. While sometimes confused, the two types of failure are conceptually separable. Market failures occur when "free" markets are unable to reach optimal output (or broader optimal outcomes) in the absence of intervention. Policy failures show that intervention intended to correct for market failure has its shortcomings as well.

Market failures include the familiar forms of externalities, natural monopoly, and public goods. The paper examines eight other causes of market failure as well. Policy failures include macroeconomic imbalances, problems with coordination and planning, and difficulties with administrative capacity.

IMPLICATIONS

Policies conceived and intended to fight urban poverty will be more effective to the extent that their advocates can anticipate the most likely points at which policies might fail. To do so, an understanding of "pure" market failures must supplement a knowledge of policies' weakest links.
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V. Conclusions
I. General Introduction

Most people in today’s developing countries are poor, using an absolute standard, and most live in the countryside, using conventional definitions of urban and rural. While the lives of many have been improved by rudimentary access to modern health care and formal education, long-lived poverty has not been vanquished.

Among the most striking movements in poor countries are rapid population growth and urbanization. Growth of the largest cities has proceeded without interruption for decades, and growth of serious poverty in them, both absolute and relative, has accompanied it. Any programs directed toward poverty alleviation should reflect these changes; they should no longer concentrate exclusively on agrarian needs and rural wants.

The demographic shift in population and poverty toward cities in low-income countries calls for a corresponding shift in attention by the institutions whose mission it is to alleviate material deprivation. Rapid urbanization and rapid growth in urban poverty mean that policy research, financial transfers, and technical assistance should all be focused more heavily on urban situations.

These changes motivate the paper that follows. It deals with two complementary explanations for poverty in general and for urban poverty in particular: market failure and policy failure. Section II spells out the general concepts of market failure and policy failure, reviews other causes of poverty, and distinguishes among three types of poverty. Section III catalogues the varieties of market failure, and mentions its applications to urban situations. Many of these are familiar; all imply ameliorating policies. Section IV looks in more detail at the policies that have been applied — policies that have been less effective than hoped or expected. The explanations for policy failures are explored, again with urban applications. A final section summarizes the work, advances tentative conclusions and recommendations, and outlines logical next steps.

The paper is addressed to professionals dedicated to economic development. It seeks analytical rigor at the same time that it consciously avoids (or, where necessary, explains) technical jargon.
II. Market Failure and Policy Failure Compared

In talking casually about market failure and policy failure, it is easy to sow confusion. Each concept has at least two distinctive variants.

**Market failure.** "Market failure" has been widely used to describe situations in which the unencumbered forces of supply and demand led to less than optimal levels of output. In the simplest terms, market failure implied that more could be produced with given resources. In what follows, this will be called Category I market failure.

More broadly and in principle, unaided market operations cannot achieve all the objectives, economic and non-economic, of the modern welfare state. This is a second meaning of market failure. It is considerably more general than the first. The two meanings should be separated. When they are used interchangeably, confusion is the inevitable result.

**Policy failure.** Unlike market failure, policy failure has not generated a theoretical literature, although allusions to it are widespread. As with market failure, two meanings can be distinguished. On close examination, they prove analogous to the two meanings for market failure. Policy failure can refer to shortcomings of public policy in leading the economy to optimal output. Seeking to correct the sources of market failure, policies fall short of the goal of achieving maximum output with given resources (or given output with minimal resources). Alternatively and more broadly, policy failure is sometimes associated with the observed inability of policies to affect the society in ways that lead to the achievement of its social welfare goals. Table 1 summarizes these comparisons.

We define poverty as a situation of low income or material deprivation. Experience suggests that not all poverty is due to market failure. Poor people may be poor because their output is not worth much. Either they do not produce much or what they do produce does not have prices sufficiently high to support them comfortably. That is not market failure in the ordinary (Category I) sense. Quite the reverse: in principle, competitive markets can readily generate these discouraging results. If a worker's marginal revenue productivity is low, her wage will be low in competitive markets, and a reliance on income from low wages spells poverty.
Table 1
Comparison of market failure and policy failure

<table>
<thead>
<tr>
<th>Market Failure</th>
<th>Policy Failure</th>
</tr>
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<tbody>
<tr>
<td>Category I: Suboptimal economic output associated with and resulting from &quot;free&quot;</td>
<td>Category I: Inability of corrective policies, acting on the sources of market</td>
</tr>
<tr>
<td>market operation</td>
<td>failure, to optimize aggregate output</td>
</tr>
<tr>
<td>Category II: Inability of free market to achieve social welfare objectives</td>
<td>Category II: Inability of policies — that intervene in markets and alter the</td>
</tr>
<tr>
<td>broader than maximization of output</td>
<td>allocational outcomes of market forces — to maximize social welfare objectives</td>
</tr>
</tbody>
</table>
In competitive markets, productivity and wages are also related to the amounts of cooperant or complementary factors of production. A ditch digger using a diesel-power backhoe is more productive and earns more than one who is equipped only with a shovel. Combining physical capital with labor makes labor more productive. In competitive labor markets, this leads to higher wages. The same can be said about raising any other input complementary to labor in the production process. In the context of incomes to workers, human capital is the most prominent of these.

Poverty may be unrelated to market failure if access to productivity-augmenting social service is unequally or inefficiently distributed. When slums are under-served by schools and health posts, their sick and illiterate residents will earn less than better endowed fellow citizens. Monopsony and exploitation by employers need not be invoked as explanations for their low earnings. The competitive market "works" in the textbook (that is, Category I) sense. Its flaw in this instance is that its results are unacceptable to societies whose expectations have grown to include humane levels of living for all citizens.

III. Market failure and urban poverty

No country, even the most advanced or affluent, has markets that work optimally, in either of the variants of optimality presented in Table 1 and the accompanying text. The section that follows regards "optimality" in purely economic terms — that is, extracting maximum output from given inputs. Important social considerations are postponed for a later section.

When markets fail to work optimally, then by definition the economy in which they operate produces less than it could. Citizens have less to consume and producers less to invest. In principle, economic policy can remedy the failures, although the possibilities for disappointment are outlined in Section IV. Analysts and political authorities alike are not usually conscious of the diversity of sources of market failure. Since each source challenges us to suggest ameliorative policies, and since there is no requirement that only one policy
might be used to correct any given market failure, the action-based alternatives quickly multiply to potentially unmanageable numbers. Accordingly, observers who think market failure in urban poverty is basically simple are fooling themselves and others. The types of market failure and their applications to urban poverty are summarized in Table 2.

1. **Externalities.** Assume that private decision-makers act in their own interests as maximizers. In doing so, they may create costs or benefits for others that do not enter into their own calculations. Thus an urban factory’s generation of pollution or a commuter’s addition to a downtown street’s congestion increases costs for others. These costs are not borne by the agent who created them. Because full costs of the activity are not charged to the agent, the agent will produce more than if she were burdened with them. From the standpoint of economic optimality, too much of the good will be produced. More technically, because competitive prices reflect only private and not social costs, equilibrium market prices will be "too low" and correspondingly quantities bought and sold will be "too high." In our examples, too many widgets will be turned out by the smoky factory; too much individual urban transportation will be sought and produced by drivers in the city’s streets.

Externalities can be positive as well as negative. In such cases the provider of benefits is not rewarded for their creation, and thus produces less than would be the case if compensation were paid. Perhaps counterintuitively, even the presence of "positive" externalities also leads to suboptimality in the economy taken as a whole.

**Implications for urban poverty.** Externalities lead the competitive market to "fail", in the narrow economic (Category I) sense. Corrective policy seeks to offset the externalities by "internalizing" them, that is, to charge full costs to the creator of negative externalities and to remunerate the provider of positive externalities. For example, policy makers can:

(a) Cut pollution by levying effluent charges on industrial and urban polluters.

Resulting improvements in health are enjoyed by rich and poor alike. The outcomes are, however, distributionally progressive, since equivalent achievement of health improvements by private spending would require a higher proportion of the income of the poor than of the rich.
Table 2

Market Failure as a Cause of Urban Poverty

<table>
<thead>
<tr>
<th>Type of Market Failure</th>
<th>Applications to Urban Poverty</th>
</tr>
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<tbody>
<tr>
<td>Externalities</td>
<td>Negative externalities: effects on public health of urban congestion, pollution. Positive externalities: neighborhood (agglomeration) effects</td>
</tr>
<tr>
<td>Natural monopoly</td>
<td>In principle, prices higher than costs in natural monopolies. In practice, urban price-gouging has other sources.</td>
</tr>
<tr>
<td>Public goods</td>
<td>Absence of incentives in free markets to supply public goods, e.g., job and health information, to urban poor.</td>
</tr>
<tr>
<td>Inelasticities</td>
<td>Lack of supply responsiveness in markets serving urban poor, e.g., housing, other long-lived capital goods.</td>
</tr>
<tr>
<td>Divergence of market and shadow prices</td>
<td>Use of capital- and import-intensive techniques rather than labor-intensive techniques that would provide greater employment to the urban poor.</td>
</tr>
<tr>
<td>Information gaps (I)</td>
<td>Costly information impairs decision-making effectiveness by urban poor and by firms catering to their needs.</td>
</tr>
<tr>
<td>Information gaps (II)</td>
<td>Faulty projections of future trends and reactions lead to less effective pro-poor policies. Public-goods nature of projections leads to under-funding from the private market.</td>
</tr>
<tr>
<td>Firms as maximizers</td>
<td>Supply responses for wage goods weakened when employees seek goals other than profits</td>
</tr>
<tr>
<td>Property rights; contract enforcement</td>
<td>Insecurity of tenure discourages capital formation by poor and by suppliers to them, especially of housing. Unenforceable contracts lower volume of transactions, especially extension of credit to poor.</td>
</tr>
<tr>
<td>Principal-agent problem</td>
<td>Differences in incentives and high costs of monitoring lead to lower output and employment in firms producing for and hiring urban poor.</td>
</tr>
<tr>
<td>Corruption</td>
<td>Lower effectiveness of production for urban poor. Sometimes a special case of principal-agent problem</td>
</tr>
</tbody>
</table>
The second order effects of effluent charges on employment have distributional effects that are not clear. The charges change the composition of output and employment in ways not easy to predict. The changes in regional origins of national product, following imposition of the charges, further complicate the analysis.

(b) Reduce congestion by requiring costly license tags for automobiles and trucks that want to enter central cities during rush hour. Collective transportation is exempt from the charge. The change in relative costs for private and collective transportation means that the remaining motorized traffic would move more swiftly. To the extent that journeys on public transportation used by the poor took less time, their welfare at the margin would be improved.

Again, interesting second order effects emerge. Changes in land values in the now less congested central business district would affect the poor in ways that are not immediately obvious.

(c) Increase information flows by providing subsidies for private providers of information. For the poor, the greatest benefits would come from information about economic opportunity. Employment bureaus are the most common example, especially in urban surroundings where the extent of market-oriented specialization is greater, open unemployment more common, and self-employment less prevalent than in rural surroundings.

2. Natural monopoly. Some economic activities generate long-lived economies of scale. The cost accountant's U-shaped cost curves, where initial economies of mass production give way to higher unit costs as volume rises, do not apply to certain activities. The generation and distribution of electricity is a common example. Local telecommunications may be another. In these specialized activities, higher volume is associated with lower average costs. More to the point, there appears to be no limit to their decline with increasing output. The U-shaped cost curve is replaced by a constantly declining one.

In these activities, firms are "natural" monopolies because any rival would have to commence operations by producing as much as the existing firm, in order to replicate its low costs. Starting small is out of the question, since a trickle of output implies high unit costs. The barrier to entry by new firms is insuperable.
An existing profit-seeking firm, a monopoly, will charge what the market will bear. And the market may be able to support a price considerably in excess of marginal cost. Production by the monopoly will be "too low" — too low in terms of economic optimality, and the price will be "too high" — higher than would be charged in a competitive environment. The electric utility or the telephone company, for example, will not produce "enough" and it will charge "too much."

Our perceptions of this kind of market failure are obscured because we seldom see it in practice. To be sure, in most countries natural monopolies are indeed identified with shortages of their output. But the presence of electricity brown-outs and under-served phone callers is due not to exploitative and unregulated monopoly, but rather to a system of regulation that has strangled the expansion of output or to state corporations unresponsive to demand. A policy failure, failure of regulation of natural monopoly, is one reason that natural monopoly is sometimes misunderstood as a source of market failure.

Implications for urban poverty. The usual policy recommendation is a familiar one. Prices charged by natural monopolies must be controlled by public authorities at levels that maintain incentives without exceeding costs. State regulation of privately owned monopolies, such as public utilities, are one policy alternative. State ownership with prices related to marginal costs rather than what the market will bear is another. Note that they are not mutually incompatible.

For the urban poor, benefits from market-based interventions in natural monopolies are diffuse at best. While society as a whole might gain from fewer brown-outs, to those stealing electricity in urban slums, lower variations on its voltage are unlikely to be important. Similarly, only through indirect trickle-down effects will more telephones benefit those too poor to rent phone lines.

The most common analytical error here is that political authorities and members of the public sometimes assume that unlimited economies of scale are present in any large firm. It is easy to observe concrete examples of bigness while the change in unit costs with higher volume remains an abstract accounting concept. Thus size of firm becomes reflexively associated with lower costs.
The economic evolution of the size of firms engaged in steel production and auto assembly in industrialized countries is instructive. Size and vast economies of scale are not always observed together. Mini-mills and smaller volumes of customized production under new technologies and new management techniques have shown that in some areas of advanced production, economies of scale do in fact have limits. The automatic presumption that efficiency would be strengthened if public policy set industrial prices or advocated continued public ownership for all large firms is contradicted by widespread evidence to the contrary.

Most big firms that finally encounter a range of output with increasing unit costs. Their industrial restructuring typically involves workers and managers whose incomes exceed those of the urban poor. In these cases, the unemployed, the under-employed, and the self-employed in the bottom quintile of the income distribution are not directly affected by the clashes going on over their heads.

3. **Public goods.** Most goods are depleted when they are used. If you eat an apple, there is one less apple in the world for other people to eat. With the diminution in supply, competition among the demanders of apples then pushes their price up slightly, discouraging people who are nearly indifferent to apples from buying them. At the same time, the change in price encourages suppliers to produce more.

One class of goods ("public goods") is an exception to the generalization about depletability. My listening to a radio broadcast does not leave any less for you to listen to. The marginal cost of supplying broadcasts to an additional listener is zero. The same is true for some, but not all, classes of information as a good. If prices are related to marginal costs, efficiency implies a zero-price for public goods.

**Implications for urban poverty.** The superficial prescription says that efficiency is served by supplying public goods without charge. In a profit-seeking market-based economy, this implies public-sector production or sponsorship. This is the source of the name "public goods." But it is too simple. In the example, commercial broadcasting by profit-seeking companies with no charge to listeners has a long history. Public ownership is not necessary
for efficiency. Efficiency requires only provision at a price of zero. That way the \( MC = MU \) equality condition necessary for efficiency is preserved.

The most common error is analytically trivial, namely, a confusion between public goods, in the non-depletable sense defined above, and goods supplied by the public sector. Most of the latter are depletable and thus are not "public goods."

For the urban poor, public goods are exemplified by information. The comments on information about economic opportunity noted in the sub-section on externalities are valid here as well.

4. **Inelasticities.** A market system works only if price changes motivate quantity responses. An increase in price must result either in a decline in quantity demanded or in a rise in quantity supplied (or both) in order to re-establish equality (and not coincidentally, equilibrium) between them. "Responsiveness" is quantified by measured price elasticities of demand and supply.

Some goods are characterized by inelastic demand or supply. If the demand for emergency appendectomies proves unresponsive to price changes, owing to the perceived unpleasantness of death from peritonitis, then a market equilibrium may occur at prices that may have little to do with cost of producing appendectomies. A market that is competitive nevertheless "fails" — not for lack of an equilibrium price, but because of the lack of correspondence between that price and production costs.

**Implications for urban poverty.** In the short-run, supply and demand for many goods and services are relatively price inelastic. For goods that can be stored, changes in inventories mean that prices can change without instant adjustments in production rates. But it takes time for consumers to re-arrange their patterns of consumption when prices change and for producers to make the substitutions necessary to produce more of a newly profitable good.

One should avoid equating short-term inelasticity with market failure. Alfred Marshall noted a century ago that, as the short run evolves to the long, both demand and supply become more elastic. The question for policy makers is thus one of assessing the desirability of speeding up the economy's responsiveness to price changes, and comparing those benefits
with their cost. To accelerate reactions of consumers and producers, for example, the authorities could provide additional information about price changes, regional inventories, new techniques of production, or under-utilized sources of credit. That is, they could decide to lower information costs in order to spur desired quantity adjustments.

With a long gestation period and an even longer useful life, housing for the poor has been identified as an activity whose supply is inelastic. Even short-lived jolts to their incomes fails to lead to an increased stock of housing. Owners of rental housing suspect that higher effective demand and associated higher prices will be temporary. By the time that new housing can be provided, prices and profits will have returned to base levels. If owners were confident that higher demand for housing, resulting from higher incomes, were permanent, quantity supplied would increase more readily, although measurements would still have to take into account the length of time consumed by the physical process of construction.

5. Divergence of market and shadow prices. For optimal output and efficiency, prices of inputs and outputs must represent the scarcity value of the resources. In the real world, they do not. In many low-income countries, the prices of capital and foreign exchange, perhaps paradoxically, are "too low" while the wage rate of labor is "too high." The superficial presumptions might be that workers "should" earn more while producers would benefit if the costs of capital and foreign exchange were lower.

Application of the concepts of excess demand and supply resolve the paradox, although many problems of implementation remain. Labor markets in low-income countries typically exhibit excess supply. High unemployment and underemployment imply that current wage rates are too high to clear the market. They are "too high," that is, to bring demand for labor into balance with its supply. And conversely, demand for foreign exchange and for loanable funds (a surrogate for capital) exceed their supply, given current interest rates and exchange rates.

Present borrowers and importers benefit from artificially low costs, while employed workers are not universally concerned that wage rates might cause unemployment for others. The qualitative relations between shadow and market prices are so long-lived as to lead to the
conclusion that the political economy is, in fact, in equilibrium. This is an equilibrium, however, that is identified with suboptimal output, that is, with market failure.

Implications for urban poverty. Policies to remedy counterintuitive analytical conclusions may themselves seem contradictory. The orthodox prescriptions suggest that the monetary authorities raise interest rates and the foreign exchange rate, at the same time that any artificial props to the wage rate (for example, a legislated minimum rate or formal legal encouragement to labor union activities) be weakened or abolished. The prescriptions should not be adopted in isolation, but there is little danger of that, owing to political resistance.

Economic policy in real countries is a package of measures, each one of which affects the outcomes of the others. For example, monetary authorities try to control simultaneously (or at least, influence) both the price of credit and the volume of loanable funds available. They do not merely fix one and then wait for the other to find its level. But greater availability of credit, even at a higher interest rate, would satisfy many would-be borrowers and leave the economy better off. Measures that made foreign exchange more expensive, coupled with parallel measures to spur exports and conserve imports, would release greater volumes of scarce dollars, marks, and yen into the market. And seemingly heartless attacks on the wage rate of unskilled labor could be coupled with training programs and macroeconomic stimulation of demand that would leave more or the urban poor employed at higher wages.

6. Information gaps (1). Economic analysis regards information as an economic good. Its possession is valued by producers when it lets them earn more and by consumers when they can use it to achieve higher levels of satisfaction. If the acquisition and interpretation of information were free, more would be better than less. Unlimited amounts of information are never sought, however, because the costs of getting and interpreting ever larger quantities become prohibitive. Instead, standard Marshallian analysis suggests that information, like any other economic good, is acquired until its (diminishing) marginal value is exactly equal
to its (increasing) marginal cost. Recent surveys of the economics of information demonstrate the breadth and applicability of the concept.¹

The acquisition, collation, interpretation, and dissemination of information, however, are subject to big economies of scale, with cost curves resembling those of natural monopoly. Marginal cost may be L-shaped rather than U-shaped. Thus despite information’s position as an economic good, it plays a role in market failure.

**Implications for urban poverty.** The policy usually recommended involves government activity. The government’s Central Statistical Office (CSO) can be justified in economic terms. Because information is a public good whose acquisition and dissemination is subject to big economies of scale, the competitive market is not the efficient instrument to handle matters unaided. The urban poor, as already noted, need information about job opportunities and chances for productive self-employment. Their effective demand is insufficient to motivate private providers to assemble and supply the information. The supplier by default is the government.

Economies in transition have long histories of collecting information from their state-owned enterprises, in conjunction with issuing orders for production. Their CSOs will evolve to resemble more closely their counterparts elsewhere. While specialized private providers will fill some information gaps, the public sector in all countries seems the preferable provider of such information as overall price indexes, balance of payments information, and economy-wide and sectoral production levels.

7. **Information gaps (II).** Information about past economic activity has its value. So too do prognostications about the future. Forecasting is as old as the human desire to know what

lies ahead. For the economy as a whole, the same concepts of public goods and economies of scale imply that public sector forecasting makes sense.

Implications for urban poverty. Faulty projections of future trends lessen the effectiveness of economic policies, including those designed to benefit the urban poor. But considered realistically, forecasting has distinct and demonstrated limits. Its reliability fades as the time horizon grows and as the unit of analysis shrinks. For macroeconomic variables, naive extrapolations are at least as good in the short run as more complex models, while in the longer run, no method has shown clear superiority. Although markets function suboptimally with imperfect foresight, it is hard to be optimistic about the cost-effectiveness of detailed and long-run forecasts dealing with activities specific to urban poor.

8. Firms as maximizers. Most models of the competitive economy assume that firms seek only to maximize profits. In real economies, the assumption of a single goal seems unnecessarily myopic. In practice, many firms act as if they sought more than one objective simultaneously. For example, some owners include on-the-job consumption (e.g., fancy offices, business lunches, trophy secretaries) and avoidance of excessive exertion in their objective functions. In such instances, net value of output is not maximized, and thus the narrowest kind of market failure (Category I) occurs.

Generalized analysis of multi-factorial objective functions encounters complications when the arguments in the function are not independent. The survival of a model which posits a single goal for its principals speaks more about the modelers' desire for parsimony than about the realism of results in applying the model. Note that the behavior described here is that of the principal or owner. Behavior of an agent at cross-purposes with a principal's instructions is covered below.

In principle, the mathematical of optimization could result in extensive computation and high costs associated with it. Optimization as a production problem has been attacked by operations research and has generated an extensive literature. Herbert Simon's contributions to the field are among the most imaginative. They capture the normal and indeed intuitive responses of real human agents, who "satisfice" within the limits of "bounded rationality,"
rather than seeking theoretically optimal production arrangements. In connection with market failure, however, note that while outcomes generated by an exercise of satisficing behavior could be socially optimal, nothing in the concept ensures such an outcome.

Implications for urban poverty. Incorporating more than one argument in the representative firm’s objective function makes more complicated the formulation of corrective policy. In a competitive economy, profit maximization as the sole maximand implies single-minded dedication by firms to cost reduction. For the urban poor, when firms in fact are not emphatically wedded to cost reduction, the result is higher prices for all goods, including wage goods.

9. Property rights and contract enforcement. If property rights are poorly defined or inconsistently enforced, output and growth will be impaired. Property rights include rights to use property (to benefit from the income stream it generates) and transfer its income streams, that is, to buy and sell it. Enforcement of contracts is another facet of the maintenance of property rights. The absence of these rights or their inconsistent application increases the risks associated with property transfers. To the extent that people are risk averse, the volume of transactions is less than it would be. A suboptimal economic outcome ("market failure") is the result.

Implication for urban poverty. The standard prescription is to define property rights clearly and to enforce them consistently. Attempts to relieve urban poverty are frustrated by insecurity of tenure. If urban land and housing can be appropriated by squatters, then its effective supply is crimped. Squatting is most prevalent precisely in those neighborhoods where decent housing for the poor is scarcest. Lending to the poor is inhibited if repayment cannot be enforced. The resulting exaggerated requirements for collateral exclude otherwise eligible borrowers, at the same time that those who qualify pay interest rates reflecting the risks.

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2 Simon’s work on these subjects from 1937 to 1982 was collected in two-volume anthology, Models of Bounded Rationality, MIT Press, 1982.
10. **Principal-agent problem.** In the private sector, a "principal" (an owner, say) instructs an "agent" to act in ways that maximize the present discounted value of the principal's income. In the event, the agent may act otherwise, in the pursuit of his own interests. The firm then operates at suboptimal levels of costs, profits, and output, and by extension, so does the economy more generally. The public sector analogue pictures the civil servant acting in her own interest rather than that of the public, in the face of clear instructions and possible sanctions against such behavior.

The problem can be traced to defects in incentive systems and to the costs of monitoring the agent's behavior:

**Incentives:** in the real world, the self-interested agent seldom faces incentives that make his interests congruent with those of the principal. The familiar prescription is to alter incentives, but details need to be carefully specified.

**Costs of monitoring:** the principal could ensure that the agent was following instructions if the principal were willing to incur the costs of monitoring closely the agent's behavior. The principal's failure to do so may reflect nothing more complicated than the high costs of monitoring — "high" relative to the returns from monitoring.

**Implications for urban poverty.** Differences in incentives and the costs of monitoring lead to lower output of wage goods and to lower employment in firms producing for the urban poor and hiring them. Small firms and self-employment thus predominate, leading to lower degrees of specialization and higher costs of output than in the absence of this mode of market failure.

11. **Corruption.** A common example of the principal-agent problem is corruption. Pursuing individual self-interest is ordinarily considered one of the bases of a competitive market. Here it has the potential for lowering overall efficiency when, for example, the supplier with a high price wins the contract by providing a bribe or when product specifications are altered to favor a certain distributor. When an agent takes a bribe to direct his organization to buy a higher cost input, then costs, output, and profits suffer.
Illegal activities raise more complex issues. If you and I trade services and under-declare our incomes-in-kind to avoid paying income taxes, we have engaged in illegal but profit-seeking behavior, without overtones of conflict between interests of a principal and an agent. Cynics (or realists) sometimes aver that these trades increase economywide efficiency rather than impairing it. The assumptions necessary for such a conclusion are as transparent as they are value-laden.

Implications for urban poverty. The most common corruption facing the urban poor is the necessity to pay off police or regulators in order to continue in a market. The market activity itself may be legal or illegal, but the payments skirt the law. They raise the incomes of under-paid civil servants, at the same time that they alter the incentive system in ways unlikely to raise the welfare of the urban poor.

Conclusions. Eleven types of market failure have been outlined. The exact number is not important; there may well be more. Ameliorists and revolutionaries alike look upon these failures as challenges. As noted in the paragraphs on implications for the urban poor, the desirable policy responses are as varied as the sources of failure. Few policy analysts recognize the multiplicity of ways that free (unintervened) markets lead to suboptimal results and unpredictable outcomes. Pressures to "do something" are irresistible, while the actions taken are insufficiently focused to be effective, even in principle. And in practice, another set of causes linked with unsatisfactory outcomes, here labelled "policy failure", also threaten. The following section deals with them in more detail.

IV. Policy Failure and Urban Poverty

Introduction. Many concepts surrounding market failure have a half-century of dignified standing in the economic canon. Policy implications for each category of market failure have been specified. But the real world, whose inhabitants are not wholly ignorant of these possibilities for corrective policy, remains in a state less than utopian. What has gone wrong? The policies derived from the identified sources of market failure have not been
applied, or do not work fast enough, or do not work at all. And we do not completely un-
derstand why. As evidence of the lack of systematic understanding, most explanations are
impressionistic, anecdotal, *ad hoc, ad hominem* — in short, particularistic rather than gener-
al.

We need a model of "policy failure" that would parallel the existing model of market
failure in its rigor and clarity. This is a tall order, so ambitious that it will not be instantly
fulfilled. But it is a worthy goal. We begin with a reminder: policy failure, like market fail-
ure, can be interpreted in two ways, as previously outlined in Table 1. Policy failure can
lead to less than optimal output levels (policy failure of Category I), or it can lead to a
composition of output and a distribution of income incompatible with broader social welfare
objectives (Category II). We cannot adequately formulate policy packages if we fail to
distinguish between the two.

A further dichotomy also helps clarify the complex issues under scrutiny here.
Policies can fail because of faulty design. Further, well designed policies can fail because of
defective implementation. Examples of each are presented in this section.

**Impressions, tautologies, and value judgments.** Most existing explanations for
policy failure are unsatisfying. They can be particularistic when they deal with single coun-
tries, regions, leaders, historical periods. As they stand, they do not readily lend themselves
to extension to broader circumstances — in a word, to useful generalization. Their specifici-
ty has moved us to become adept at inventing good reasons why lessons from Chilean experi-
ence cannot be applied in Papua New Guinea, or why Singapore may have little to say to
Nigeria. Unfortunately, these conditioned reflexes are neither positive nor constructive.

Equally unsatisfying are explanations that turn out to be tautological and are therefore
non-operational. The most common example is the "explanation" that a policy failed be-
cause of "lack of political will." That is not analysis; it is an intellectual evasion. Following
this reasoning, policies that succeed must have embodied adequate or appropriate levels of
political will, while those that fail can be forthrightly blamed on lack of leadership or civic
consensus. Worse, tautological explanations are usually freighted with unstated value judg-
ments about moral failings, political cowardice, or stupidity. Evasions masquerading as
explanations allow the analyst to cast blame without prescribing useful remedies. One wonders who is really helped by the common admonition to "Exert leadership."

**Operational categories of policy failure.** It is fortunate that beyond tautology, there lie potentially useful ways to categorize or classify policy failure. The criterion for "usefulness" of a category is its capacity to shed light on problems arising in operational situations. This section treats first the failures associated with shortcomings in policy design. Later, failures attributable to defective implementation are mentioned. Both are summarized in Table 3 and discussed in greater detail below.

**Failures in policy design.** The first three types of failure in policy design are macroeconomic. They have earned renewed prominence in the process of adjustment following debt restructuring and re-finance, although problems of macroeconomic adjustment have been treated in one form or another ever since the exchange economy came to dominate economic life.

1. **Fiscal imbalance.** Resolutions to strive for fiscal balance are as common as their achievement is rare. Explanations for imbalance seem simple. In democratic countries, the desire for re-election means that public spending is more popular than raising revenue through taxes. In authoritarian governments, the possibilities of unwelcome turnover at the top can be mitigated by popular goodwill, with spending and taxes having the same relative appeal as in democratic countries.

   Even the most affluent countries have found it impossible to achieve fiscal balance in the last decades of the twentieth century. Policy analysts are thus reduced to recommendations about holding the deficit within historically or internationally reasonable limits. Purists cringe, but they have not been able to suggest better solutions.

   At the mesoeconomic level, one variety of intra-governmental transfers ("bail outs"), benignly intended to alleviate financial distress prove extraordinarily dysfunctional. They create perverse incentives, since the agencies or state corporations that run the biggest deficits earn the highest rewards. They serve as an example of a Type I policy failure.
Table 3
Policy Failure as a Cause of Urban Poverty

<table>
<thead>
<tr>
<th>Type of Policy Failure</th>
<th>Applications to Urban Poverty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal imbalance</td>
<td>Fiscal constraints squeeze out projects benefiting urban poor. May also lead to fiscal stratagems (&quot;off-budget&quot; accounting) that upset macro-economic balance</td>
</tr>
<tr>
<td>Price instability</td>
<td>Rapid inflation lowers real incomes of urban poor</td>
</tr>
<tr>
<td>External imbalance</td>
<td>Import restrictions lead to higher consumer prices. Foreign direct investment (accompanying import surplus) fails to generate jobs for unskilled urban poor.</td>
</tr>
<tr>
<td>Inter-sectoral linkages</td>
<td>Neglecting the tool of interindustry linkages means ignoring sectors most appropriate for tax incentives, subsidized R&amp;D, and specialized employee training</td>
</tr>
<tr>
<td>Allocational role of prices</td>
<td>Failure of authorities to force market prices to reflect resource costs, e.g., in cases of externalities, monopolies (natural and otherwise)</td>
</tr>
<tr>
<td>Political economy</td>
<td>Urban bias reflects middle- and upper-class urban interests, rather than being effectively pro-poor.</td>
</tr>
<tr>
<td>Short planning horizons</td>
<td>Impatience by urban poor and their representatives for immediate results blocks potentially valuable medium-and long-term projects and policies</td>
</tr>
<tr>
<td>Narrow participation</td>
<td>Failure to use knowledge and wisdom (&quot;inexpensive information&quot;) held by urban poor as project beneficiaries</td>
</tr>
<tr>
<td>Unforeseen outcomes</td>
<td>Imperfect foresight and incomplete information diminish effectiveness of pro-poor interventions</td>
</tr>
<tr>
<td>Regulatory framework</td>
<td>Contradictions between regulations and incentives set for individual agents stunts income growth for urban poor, in both goods markets and factor markets</td>
</tr>
<tr>
<td>Inter-regional policy</td>
<td>Concentration on rural and agrarian issues distracts attention from urban poor</td>
</tr>
<tr>
<td>Policy implementation</td>
<td></td>
</tr>
<tr>
<td>Administrative capacity</td>
<td>Underdeveloped administrative capacity leads to less effective action on behalf of urban poor</td>
</tr>
</tbody>
</table>
Implications for urban poverty. In this setting, increased fiscal allocations for anti-poverty programs face a double disadvantage. They upset fiscal balance without extending significantly political survival. Recommendations to combat urban poverty by relying on higher public spending may be technically correct, but they represent the triumph of hope over political experience, and usually fail.

Fiscal pressures also stimulate accounting end-runs. Establishing new off-budget entities to deal with urban problems, or taking existing institutions off-budget, is one response observed in affluent countries. The real effects on resource allocation of such changes are transparent. Whatever their justification on other grounds, they upset achievement of the goal of macroeconomic balance.

2. Price instability. Monetary discipline is equally unusual in low-income countries. Even countries struggling with hyper-inflation appear unable to retard growth rates of the money stock. Explanations usually cite the Central Bank’s lack of independence from the government. Pressures on the banking system to fund budgetary deficits or private-sector credit expansion are perceived as irresistible. Inflation distorts economic allocation and leads to policy failure of both Categories.

It is possible to classify monetary expansion of inappropriate magnitude as a failure of design or as a failure of implementation. Some would say that the designs of most anti-inflationary programs are flawed, and this explains their failure. Others, more orthodox, complain that even the simplest policy design is faultless: reduce the rate of growth of the money stock. In their opinion, failure to implement this correct design lies behind the policy’s shortcomings.

The solution is easy to specify and hard to do. Political consensus about the benefits of an independent monetary authority must be achieved. The difficulty of arriving at consensus is apparent even in countries where price stability prevails. The issues are more subtle and more controversial than most mainline economists are willing to admit. As a result, the familiar battles between a conservative ("prudent") monetary authority and a populist ("spendthrift") government boost the sale of newspapers without resolving the dispute.
Implications for urban poverty. Rapid inflation ("price instability") lowers the real incomes of the urban poor. Wage earners are seldom fully protected by wage indexation. The poor living on fixed incomes lose proportionately to the speed of the rise in prices. The self-employed may be able to ratchet their money incomes upward as inflation proceeds, but this assumes unrealistically that employment levels and real aggregate demand remain unaffected by the monetary imbalance. Small shopkeepers can raise the prices of their goods, but they must pay more when they re-order, so they remain one jump behind. And once again, the political clout of the urban poor is unlikely to be great enough to overcome the pressures from other interest groups that favor inflation, or at least that oppose a quick return to price stability.

3. External imbalance. Countries encountering balance of payments crises do not always devalue. Or they devalue too little or too late. Balance-of-payments crises are usually accompanied by rapid inflation. The authorities realize that devaluation, combined with predictably permissive monetary expansion, will extend inflation. More inflation leads to a corresponding fall in real incomes, as noted above. As with the other macroeconomic imbalances, the solution requires coordination of macroeconomic policies to achieve simultaneous internal and external balance.

Implications for urban poverty. Failure to achieve external balance affects the urban poor in a number of ways, none of them good. Attempts to restrain imports lead to higher prices of imports and their domestically supplied substitutes. The import surplus may spur foreign direct investment, but the composition of its employment leave the urban poor largely untouched. And repeated failure to achieve a coordinated internal and external macroeconomic balance leads to unstable expectations, with the diminution on aggregate demand mentioned in the previous section.

4. Inter-sectoral linkages. Privatization and industrial re-structuring are common in low-income countries. Newly privatized or partially restructured economies need to generate signals that mimic those given by a competitive economy. Nowhere is this more important than in industries with major intersectoral purchases and sales. In economies in transition,
these industries were formerly centrally planned and their output artificially priced. They, in particular, have a long way to go before they replicate competitive economies. But inter-sectoral linkages are important to other low-income countries as well.

Among the activities most valuable for economic development are those with the strongest links to other economic sectors: backward links between sectors and their suppliers; forward links between sectors and the buyers of their intermediate goods. The size of the linkages is measured by the size of the coefficients showing inter-industry flows in the country’s input-output table. Sectors with the biggest coefficients, representing large inter-industry flows, generate greater economic activity and thus higher benefits for their suppliers and customers than other sectors.

**Implications for urban poverty.** Measurement of the size of inter-sectoral linkages and identification of the biggest ones are the first steps in policy. Greater output can be spurred in sectors identified as highly integrated with the rest of the economy. Sector-specific tax incentives, subsidized and focused research and development, and specialized employee training are among the tools usually prescribed for this purpose. To advocate this targeted approach requires conviction both that the market imperfections described here require government intervention, and that policy can be effectively implemented. In the real world, neither is assured.

5. **Allocational role of prices.** Prices, as indicated in the section on market failure, should always reflect scarcity values. Prices act as signals. In a competitive equilibrium, they represent the incremental costs of supplying another unit as well as the additions to satisfaction of the final consumer, or the marginal value product to the purchaser of intermediate goods. In economies in transition and in other low-income countries with large state-owned enterprises, current prices of intermediate goods and final outputs do not perform this role reliably. Many prices are relics of a past in which they were arbitrarily assigned for accounting purposes, but had little influence over decisions about purchasing or substitution.

**Implications for urban poverty.** The corrective policy is straightforward. To the extent that authorities, rather than the market, continue to set prices, the prices should reflect incremental (“marginal”) costs and values. The urban poor would be the beneficiaries of the
resulting switch to more labor-intensive techniques of production, and of the greater reliability of supply of urban public services.

6. Political economy. Some failure in policy design can be traced to instincts of political survival. Assume that elected officials have only a single argument in their utility functions, namely, the length of (their) term in office. Incumbents therefore favor policies and projects that lead to re-election. When they compose their campaign strategies, aspirants to elected office are quick to mimic incumbents' formulas. In this environment, the most appealing policies include projects with blockbuster visibility (big dams, ambitious highways, new-from-the-ground-up national capital cities). Besides being large and visible, the preferred policies allow local representatives to claim credit for them, and they use public employment as patronage.

Political forces can lead to defective policy design even when public works are not involved. Examples abound: pensioners have greater capacity for effective political organization than do children. Public expenditures for old people are likely therefore to exceed those for children. This, although the social rate of return might be higher for many child-centered policies, including nutrition, literacy training, curriculum reform, and extended programs of immunization. In this case, political forces have biased outcomes in favor of transfer payments over human capital investments, despite the obvious superiority in the rates of return to investments.

Implications for urban poverty. Political behavior also creates urban bias. A concentration of public spending in cities is one manifestation. Less obvious are price policies that favor urban residents, or public works activities that employ urban workers disproportionately, or easier access to subsidized public works in towns than in the countryside. These imbalances represent policy failure in design, unless we believe that city

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3 Under the theory of public choice, other maximands are possible: "power," size of staff, amount of budget, etc. The same principles apply. Note that these maximands may as readily be sought by private-sector managers in large corporations.

4 Michael Lipton, Why Poor People Stay Poor remains the standard reference.
dwellers are inherently more deserving than country folk. The failure is caused by greater political power of urban populations, relative to their size.

The prominence of urban bias sometimes leads policy makers to overlook its regressive effect on the incomes of the urban poor. While it is true that bias leads to income transfers that favor cities, they are not equally distributed there. The poor are excluded from the benefits of many urban infrastructural investments. Their gains are clearly limited when monumental capital cities are created in the wilderness.

Among the price policies that favor urban residents are those that subsidize urban consumption. Subsidies for bread or rice (which city people consume but do not produce), urban transit systems, public housing complexes, and modern communications systems are examples of transfers to urban consumers. Failures of price policy need not involve public spending for subsidies. Rent control regulations, while less popular in poor countries than rich ones, distort housing supply in ways easily shown to be distributionally regressive.

Returning to a theme introduced in the previous section, if urban projects are more capital- and import-intensive than rural ones, the twists in the prices of capital and foreign exchange described in the section on market failure also represent failure in the design of policy. That is, market failure has not occurred simply because an unencumbered market has generated a suboptimal value of output, as would be the case with externalities, for example. Instead, the roots of market failure lie in a public policy that gives incentives so effective that individuals are induced to conduct their economic affairs in ways inefficient for society. Market failure rather than being "natural" is induced by policy failure — by failure in policy design.

While the urban poor have the advantage of being close to the scene of political action, their organizations have not been effective. As noted, urban bias in practice contains elements that reflect the interests of middle- and upper-class urban residents, rather than the poor.

7. **Short planning horizons.** Resolving any policy question involves a tug-of-war between short-term and long-term considerations. The rate of time discount is the organizing principle for understanding what is at issue. When it is suggested that short-term considerations
are more important, the assertion simply implies the existence of high subjective discount rates.

Politicians who live and die by the delivery of instant services and benefits to their constituents are criticized for their orientation to the short run. This should come as no surprise. They would be out of office if they were not. That is, their planning horizon being short, it is not surprising that they discount to zero any result that will not occur until after the next election. The closer the election, the higher the rate of time discount and the shorter the effective time horizon over which the stream of costs and benefits associated with any policy is implicitly evaluated. More generally, the political environment has habituated politicians to act as if they have high discount rates.

Analysts employed by universities or think tanks typically take a longer-term point of view. They say that, "Policies should focus on long-term issues. Only the state, as ultimate fabricator of 'policy', has the luxury to do so." In this Platonic ideal, only those insulated from the whims of people with their truncated time horizons and high discount rates can be relied on to preach wisdom, that is, to advocate "sensible" or "wise" policy. Here, sensible policy is congruent with optimal policy only if low discount rates are used to evaluate costs and benefits.

Applying the same principles, the unemployed are more oriented to the short term than are people with jobs. Consumers are willing to pay more for credit than firms. Other instructive comparisons can be made, but all represent the same phenomenon, that is, the differences in the rate of discount thought appropriate by different groups.

How does this relate to failure in the design of policy? A policy might succeed in the short term and fail in the longer term. Considerations of "policy failure" should acknowledge this dual possibility to avoid confusion.

Implications for urban poverty. As a long-lived phenomenon, urban poverty should be confronted with policies not confined to the short-term. Policies such as skill training and other human capital formation, housing, and reformed property rights will not bear instant fruit, but are clearly beneficial in the longer run. Improvements in urban poverty are thus impeded by the short planning horizons that lie behind much policy design.
8. **Narrow participation.** Absence of timely and practical information about local circumstances can lead policies formulated at the top to fail. More information would save the situation, but information is subject to analysis of benefits and costs at the margin. Policy makers can always be better informed if they are willing to bear the costs.

**Implications for urban poverty.** The appeal of popular participation in urban project design comes from its implicit economy of the process of gathering and interpreting information. People most closely involved with a process, product, or region can bring their experience to bear without recourse to expensive "experts." Conversely, unwillingness to tap these cheap sources of information lead to faulty project design and hence to policy failure.

9. **Unintended and unforeseen outcomes.** Policies may be well designed, but may fail simply because their outcomes are unintended or unforeseen or both. Unintended by those responsible for designing them. Unforeseen by them or by the public more generally. And in either case, unannounced. This is hardly a combination suggesting managerial competence, political ability, or moral authority. Besides the failure of the policy itself, a (negative) halo effect may convince individuals that investing and other spending is fraught with unforeseeable risks, and should thus be avoided in the interests of capital conservation. The spread effects of unforeseen outcomes can therefore dampen considerably the "animal spirits" so important to economic growth.

Some unforeseen outcomes are acts of God. The policy would have worked had the monsoon come as before, or the flood been prevented. Others are caused by professional lapses: the civil engineers did not calculate correctly and the dam broke. But, for the economist or policy analyst, the most interesting examples lie in incorrect or superficial economic analysis. No one realized that building a new road to fight traffic congestion would lead to even more congestion, because everyone overlooked the incentive effects of the new road's contribution to lower vehicle operating costs.

Again information costs form a guiding principle. More knowledge avoids, or at least mitigates, mistakes in policy design and analysis; more knowledge also has its costs. How much is enough, how much too much? Inevitably even the informed application of the marginal calculus requires judgment, and it is all too easy after the event to criticize policies that
fail as have used faulty judgment. That may be true, but it is not a helpful guide to policy formulation.

**Implications for urban poverty.** Policies affecting the urban poor are at least as subject to unintended outcomes as others. The urban economy can be seen as a general equilibrium system with myriad interactions. These relationships can challenge model makers and policy authorities beyond their current capabilities. Unforeseen outcomes traceable to omitted variables or mis-estimated elasticities mean that intended benefits for the urban poor may fail to materialize.

10. **Regulatory framework.** At least two design failures are possible. Both are based on the difficulty of comprehending the overall effects of the regulatory system. Consider first a situation in which regulations to correct market failures are passed. Unless perfectly coordinated, they may contain unanticipated internal contradictions; that is, one may undo the effects of another. Furthermore, taken in their totality, the costs of compliance may be so great as to overburden the system in ways that lead to suboptimization of value of output, that is, to failures of Category I. Hernando de Soto is convinced that this characterizes anti-economic business regulation in Lima, but he is only the latest in nearly a century of writers that began with Thorstein Veblen to voice concern on these matters.\(^5\)

**Implications for urban poverty.** As the World Bank has observed, regulations have an especially heavy impact on small enterprise and therefore on poverty.\(^6\) Because compliance with regulation usually involves economies of scale, small businesses are especially burdened. The observed rush to economic informality is the natural economic result. A similar distortion can affect consumer spending on housing. Policy-based enforcement of sophisticated building codes, inappropriate for urban populations living at low incomes, diminishes the supply of housing and leads to growth in shantytowns.

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\(^5\) Veblen, *The Engineer and the Business Man*, (1906).

11. **Inter-regional policy failure.** Rural policy failure can lead to urban distress. A frequent but flawed explanation takes this path: Any policy that pushes people out of the countryside increases the rate of urban population growth and thus the growth in demand for scarce public sector resources in cities. The explanation assumes that the government is the principal provider of infrastructure services, including housing. Rural policy failure provided the push. Urban residents (or taxpayers at large) bear the cost.

There is more here than meets the eye. To begin, it is superficial to attribute rural pushes exclusively to policy failure. Instead, expulsion from agriculture may be caused by success in increasing rural productivity. Lower demand for rural labor should not reflexively be labelled "failure." It would represent failure if society’s goal were stasis or an absence of structural change. But those who advocate national development do not seek such objectives. Lower demand for rural labor is properly criticized when it results from a decline in aggregate demand for output. But deficient aggregate demand and higher rural productivity are hardly congruent. Focused analysis can avoid confusion by distinguishing between them.

**Implications for urban poverty.** If rural people come to town and "demand" services, the services could be provided more readily if cost-recovery mechanisms were in place. Distribution of electricity and water to the city’s new neighborhoods could be paid for by the users. In the real world, unit costs routinely exceed public utility tariffs, with the central government subsidizing the utility companies (whether state corporations or state-regulated private firms). Failure in the design of price policy can generate results that reflect policy failure of Category I, if not always of Category II.

**Failure in policy implementation.** The list of types of failure in policy implementation is mercifully shorter than the list of failures in policy design. In fact, only a single subcategory suggests itself. It is universal, however, and has been observed and cited by every participant in project and policy evaluation.

**Administrative capacity.** Even when "correct" policies are designed, making them work requires professional, technical, and organizational capacity. When that capacity is missing, the policies will fail. And they will fail as visibly as if they were poorly designed. Tautology can play its usual irritating role. As an example of tautology disguised as explana-
tion, success in implementing a macroeconomic adjustment program in one country was attributed to its "tradition of public service and administrative competence." If the program had not succeeded, the failure would presumably have been explained by the absence of such tradition.

More than tautology may be involved, however. Drawing on the original Prussian model of bureaucracy, educated and rule-bound civil servants have more "capacity" for efficient administration than political hacks or protected time-servers. Formation of a social value system that rewards administrative capacity requires a period of time so long as to make development economists uncomfortable. That, in turn, underlies the common complaint about the absence of administrative capacity.

**Conclusions.** When markets fail, we look to national policies to supply remedies. Many policies seem to promise more than they deliver. In asking why, we recognize that policy design faces a complex set of problems, and that the pitfalls facing policy design are many. Further, even policies that incorporate technically correct solutions to problems of market failure may nevertheless go off the tracks. Failures of implementation may call into question the sophistication of design, but conceptually they can be considered separately.

V. **Conclusions**

Analysis of market failure has been associated with a degree of rigor allegedly lacking in analysis of policy failure. It is not instantly clear why this should be so. The same maximizing assumptions lie at the heart of both. To be sure, policy failure is more closely associated with political economy and public choice, but these models and metaphors are at least as plausible as those that describe market failure.

When it occurs, any kind of failure results in sub-optimization in countries whose people can ill afford it. The present paper has called attention not only to the multiple causes of failure, but also to their inevitable interactions. This poses an obvious problem to
politicians. If they tried to take into account all the alternatives mentioned here, their messages, and thus their possibilities for effective leadership, would be lost in a swamp of detail.

At the same time, the conceptual framework of failure extends great promise to analysts, including those in international organizations. Separated from the most pressing day-to-day political pressures, with job tenure less dependent on popular acceptance, professionally well prepared, and backed by elaborate information-based resources, these analysts routinely render service and make recommendations unobtainable from any other source. If they can extend their scope so as to recognize fully the possibilities for failure, as outlined above, their contributions can be unique.