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Development Paths: A Case for Public Investment as the Alternative to the Washington Consensus

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Development Paths

A Case for Public Investment as the Alternative to the Washington Consensus*

Earta Lauka

Abstract

This paper's aim is to provide a different standpoint in the development debate, by focusing on the short-sightedness of the international institutions when they propose a development agenda. Focusing on macroeconomic performance and on privatisation, they have found a solution in PPPs, which offer financing opportunities for public investment and at the same time they reduce the burden on governments budgets. As an alternative this paper proposes a model based on investment and self-dependency with combining elements from post-Keynesian theory as well as the Beijing Consensus. The model rests on the importance of SOEs to use industrial policy as a tool to achieve independence from western powers as well as to increase investment. The theoretical claims are supported by empirical analysis based on 98 developing countries over a 15 year period.

JEL classification: F14, F52, O21, O25, O38,

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1. Introduction

Development has always been a very controversial and debatable topic. Since WW2, international institutions and forums with the most important heads of states have taken an imposing position on the path to development. The most significant list of recommendation is known as the Washington Consensus, a term coined by J. Williamson (1990). The original proposal consists of ten policy recommendations for developing countries to follow in order for them to develop faster. After a severe critique, the original list has been revised to include additional points. Of relevance to this paper is one of the recommendations, the issue of privatisation, which has remained unchanged. Since 1980, this has been considered a mission for all countries seeking a Western model of development. Williamson, and by now most international institutions, stress the need for developing countries to privatise and for the state to remove itself from the market. However, one major trend in development recently has been the inclusion of public private partnerships (PPPs) as a means to finance investment. The main issue with which this paper deals is the short-sightedness of the international institutions when they propose a development agenda¹. Too much attention is given to macroeconomic indicators of economic performance by putting investment in a second plan. By emphasizing the former issues, the western model of development promotes PPPs, which are very incremental investment strategies. Throughout the literature review there is a missing point in evaluating the effectiveness of PPPs, which is viewing them as separate individual projects that work independently. This is why this paper brings forward the case against privatisation and argues for direct state involvement in the markets through industrial policy. Using a combination of post Keynesian theory of development and the Beijing Consensus as background this paper models a path for development, with a strong focus on state owned enterprises (SOEs). The latter are legal entities where the state owns at least half of the stakes. They allow governments in developing countries to pursue development strategies more efficiently and on a national scale. While this paper supports the inclusion of SOEs towards development, it does not argue that SOEs are better than private enterprises. What it argues is that when faced with a choice of a PPP or an SOE, governments should choose the latter.

The paper's structure lies in presenting the theory for the most part, with the empirical analysis as one of the last parts. More precisely, chapter two outlines the mainstream theory of development. The section starts with the general understanding under the term Washington Consensus and the rest of the section looks at the phenomenon of PPPs as one of the tools used

¹ This paper will focus on economic development alone and will not deal with other aspects of development goals as put forward by international institutions.

by policymakers in line with the Washington Consensus. What follows in chapter three is the theoretical alternative that this paper supports, i.e. direct state investment via SOEs as a more efficient way for long term development. In a similar fashion to chapter two, this part will show that investment is crucial for development and as such it should be given central attention. In chapter five the paper focuses on the empirical analysis conducted with secondary data and using a regression estimation. Following the results from the study, section five will assess the theory combined with the empirical results and draw lessons from it.

2.0 The Washington Consensus

The most influential development agenda in an international scale falls under a neoliberal ideology and it is known as the Washington Consensus. The term was coined by John Williamson (1990), representing the idea that there was a consensus between the US executive branch of government and the main international institutions financing development projects in the world, i.e. the International Monetary Fund (IMF) and the World Bank. The main ideology behind it is to bring change in society as well as politics to represent a free market liberal thinking, rising from the model of western societies. In this framework the state is encouraged to function simply as a supervisor of regulations. Although Williamson argues that these recommendations do not exactly fit the suit of the neoliberal agenda, the Washington Consensus is used interchangeably because of the full support given by the IMF, WB and the U.S Treasury Department. In fact, it was Dani Rodrik (2002) that summarised the ten points by also augmenting them with another ten in line with the recommendations from the aforementioned institutions, which were with a strong emphasis on institution building and social reforms².

²While Williamson separates his Washington Consensus recommendations from neoliberalism, in this paper they will be used interchangeably, because as admitted by the author “....privatization is the only doctrine for which one can trace a specifically neoliberal origin that made it to my list of ten desirable reforms...” Williamson (2004:10). Given that this paper is mostly concerned with the recommendation on privatisation, the interchangeable use of the two terms is justified.

Table 1. The Washington Consensus Recommendations

<i>Policies</i>	<i>Washington consensus</i>
Fiscal discipline	Small budget deficit financed without recourse to inflation tax.
Public expenditure priorities	Redirect expenditure from politically sensitive areas to fields with the potential to improve income distribution, such as primary education, health care and infrastructure.
Tax reform	Broadening tax base and cutting marginal tax rates.
Financial liberalisation	Market determined interest rates.
Exchange rates	A unified competitive exchange rate.
Trade liberalisation	Replace quantitative trade restrictions with tariffs of around 10–20%.
Foreign direct investment	Abolish barriers to entry for foreign firms.
Privatisation	State enterprises should be privatised.
Deregulation	Abolition of regulations that impede entry of new firms or restrict competition.
Property rights	Secure property rights which are also available to the informal sector.

Source: (Marangos, 2014:70)

In Latin America, faced with the Washington Consensus reforms as a conditionality for support by the international institutions, countries opened to trade and started pursuing these reforms. However, they started very soon facing difficulties and in fact another crisis hit them in 1998 (Ocampo, 2000). Therefore, the ten-points prescription started to lose its shine and became heavily criticised by scholars. Among the heaviest critiques are those of Stiglitz (2008) and of Rodrik. The first argues that these measures should be taken very slowly and only once there is a strong institutional base in place. Rodrik (2006) on the other hand criticised the fact that one prescription is supposed to be the solution for every country facing difficulties, completely ignoring the historical, cultural and geographical differences countries have among each other. Given the heavy criticism and the evidence from countries that had used his policy recommendations, Williamson revised the prescription by expanding and rephrasing his initial ten points in a publication together with Kuczynski (2003).

In the revised prescription (see table 2) they argued that there should be fiscal discipline in countries seeking to develop, in terms of aiming to stabilise inflation, increase savings and constrain budgets. In addition, public expenditure was recommended to be spent in stabilising the economy and for better education. In terms of taxes, property and income taxes were to be introduced as well as tax revisions to close loopholes and avoid capital flight. Given the problems caused by the initial recommendation in East Asia and in Latin America, financial liberalisation moved from market determined interest rates to a stable rate of inflation. After the dollarisation of debts in many countries, they recommended that countries should have freely moving exchange rates but avoid dollarisation. Trade liberalisation was deemed to have worked and was suggested to go even further to complete market openness. Slight improvements through

rephrasings were recommended in terms of property rights and deregulation. The most important change was the inclusion of institutional building as a recommendation. After the criticism that he received, Williamson was convinced that the state had a crucial role in establishing good institutions and governance. In addition, they briefly discussed the role of the state in providing public goods and infrastructure and solving market failures, in helping to redistribute income in favour of the poor and in general to fine tuning the economy through reforms in education, in the civil service and in the financial sector. For instance, progressive taxation was suggested to redistribute income from the rich to the poor and to increase social spending to benefit the former group. At the same time, they suggested that these policies should not be pushed for too much because of the risk of capital flight from Latin America to Miami for instance and that this redistribution takes a long time (Kuczynski and Williamson, 2003).

The most significant point for the purpose of this paper was the commandment for privatisation. While some of the initial recommendations were not significantly altered, Williamson remained convinced that privatisation should have continued to be carried out even though thus far it was carried out very poorly. He laid very little trust on the state as the initiator of major change or the qualified identifier *ex ante* of an industry to deserve subsidies, as Rodrik (2004) would propose. Private ownership remained before the state and the role of the state was considered to be enabling and not providing (Arnold and Kehl, 2010). However, Williamson has admitted that at least in Latin America there is great public hostility towards privatization because it is just a tool that corrupt officials can use for their personal agendas. They allow private companies to take on monopolies in exchange for campaign support or simply money on their offshore accounts. He has also recognized that privatisation has led to wealth being concentrated in the hands of the few. For this reason, international institutions are now pushing forward PPPs as tools to provide better efficiency, but still be accepted without hostility and without the risk of turning into monopolies or skewing income distribution towards the hands of a few. While PPPs are marketed as tools to finance public investment they seem to be more a language game to hide the larger agenda towards privatisation.

Table 2. The New Agenda

<i>Policies</i>	<i>New agenda</i>
Fiscal discipline	Stabilising inflation, sub-national governments subject to hard budget constraints, increase domestic savings.
Public expenditure priorities	Stabilise the real economy through Keynesian policies, establish a stabilisation fund, improved educational opportunities.
Tax reform	Establishing property taxation as the major source of revenue, elimination of tax loopholes and taxing income earned on flight capital.
Financial liberalisation	Monetary policy targeting a low rate of inflation, strengthening prudential supervision.
Exchange rates	Flexible exchange rates, minimise the use of the dollar.
Trade liberalisation	Complementing import liberalisation with better access to export markets in developed countries.
Foreign direct investment	As the original Washington Consensus.
Privatisation	Continuing the privatisation programme, even though in some cases, it was carried out badly.
Deregulation	Liberalising the labour market.
Property rights	Programmes to provide property rights to the informal sector, land reform and microcredit.
Institution building	A role for the state: maintaining effective institutions, in providing public goods, internalising externalities, correcting income distribution, decent infrastructure, a stable and predictable macroeconomic, legal and political environment and a strong human resource base. Reforming the judiciary, education and civil services, building a national innovation system, modernising the market institutional structure and institutional reform in the financial sector.

Source: (Marangos, 2014:72)

2.1. What Are PPPs?

The term PPP faces the usual problem of no unified definition, although all definitions have the following common features: they refer to a cooperation among at least two parties, where at least one is public; the relationship is long lasting, stable and sharing mutual goals and all parties have a share of risks and responsibilities (Milosavljevic and Benkovic, 2009). The World Bank definition of a PPP is: “any contractual arrangement between a public entity or authority and a private entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility” (World Bank, 2016). It includes brownfield and greenfield projects as well as performance-based management contracts. Officially, there are four main types of PPP agreements (Quiggin, 1998). The first and most common one is known as a build operate transfer (BOT); here the private entity is responsible for building the facility linked with the project, for operating it for a given number of years as per the agreement and finally transferring it back to the government at the end of the agreement. One example of this is the

Elbphilharmonie in Hamburg. Another type of contract is a build-own-operate-transfer (BOOT). The difference from the first is that here the company actually has full ownership of the project for a limited period of time as stated in the agreement. One example of this is the international airport of Tirana in Albania, where since 2016 a Chinese company is in charge of all operations after its three previous shareholders sold them the operating rights. In 2027, this concession will terminate, and the airport will be back in state ownership (Tirana Airport, 2016). The final model is known as a build operate own (BOO) and it consists of a private entity completely being in charge indefinitely of a project with no government involvement in the terms. However, the government enters this kind of project in facilitating the realisation of it, with the claim that the project provides a public good. For instance, to build a railway in a remote area in India, where it does not make sense to have competing services, the government helps the private firm by using its powers of coercion to resume land, compulsorily, in order that the private builder of the railway line can proceed (Quiggin, 1998).

The concept of PPPs started to gain momentum in the late 1990s, but the idea of concessions has been around for centuries (Arnold and Kehl, 2010). Initially the idea was that the private company invested their own money in return of monopoly status guaranteed by the government. In this way the company could get returns on their investment by charging users for an indefinite time. These agreements were done in industries that required a large amount of initial investment to providing services such as water, gas, electricity and infrastructure. Given their inability to comply with the required size of investment and at affordable rates, these investments went back in the hands of governments using public finance. This modern concept of PPPs where the company is paid by the government rather than the consumer was invented in the UK during Thatcher's rule of government (Hall, 2015). The UK in fact has a very long list of PPPs and it leads the leagues of country comparisons. In developing countries, the idea of PPPs as an opportunity started in the 1990s, encouraged by development banks and multinational companies as part of the greater agenda of privatisation. They pointed at sectors like water and energy, where PPPs remained the main form of privatisation taking place through a concession or a lease contract most often. Since Thatcher brought these agreements back into fashion the number of them has increased exponentially and they have spread worldwide. In 1990, their total investment value only in developing countries was \$7 billion and in 2012 that value was \$158 billion. They were in particular helped by the financial crisis in 2008. While borrowing from banks became very difficult for private companies, governments were also faced with very stringent economic conditions and were forced into austerity policies. As public investment is always needed, governments became ever more attracted to this opportunity, where both parties would win, the government by actually providing services for the public and the private firm by

getting access to credit with favourable interest rates. While it is true that PPPs saw a drop-in value during the crisis, they saw a much sharper increase after the crisis in both value and numbers of projects (World Bank, 2016).

The promotion of PPPs mainly takes two forms: marketing and promoting campaigns globally and through direct financing of such projects via subsidies to the private borrowing of PPPs. Like a spider web, the network is expanded from the global level to regional, sectoral, national and local levels. The leading role, understandably, is taken by the international financial institutions (IFIs) like the World Bank (WB) and its private sector funding branch (the IFC), regional development banks like EIB and EBRD and the IMF. These institutions act for both marketing and funding the PPP model. Their role is crucial for PPPs especially in financial terms. This is due to the fact that IFIs lend them money at the same preferential rates as those for government loans for projects which commercial banks would not support (Hall, 2015). Nowadays, most of the loans given by IFIs go to these projects.

The two main platforms for the promotion of PPPs are the WB and the European Commission. WB has become such a large force of influence for PPPs that it now has a separate entity under the name of World Bank's Public Private Partnership Group Infrastructure, which focuses on guidelines and support for governments using PPPs for investment in infrastructure. While the WB can only provide funds to governments, its subsidiary IFC offers funding solely to the private sector. Every loan given by them be it for infrastructure projects, public service sectors like water, energy and healthcare, all come with the conditionality of privatisation. Since the last financial and economic crisis an increasingly large proportion of WB funds is taken by the IFC, sending over \$2 billion public funds to private equities or PPPs in developing countries (IFC, 2013). The European Commission is not left behind in its promotion of PPPs, especially by using accounting rules by Eurostat which exclude PPP finances from government debt as an advantage of PPPs (Eurostat, 2013).

2.2 Advantages of PPPs

The most important reason put forward by governments that show support for these agreements is the positive impact on budget constraints. During the past decade, after many countries were badly hit by the financial crisis, the retaliating measures in most economies were directed towards austerity. Faced with rising budget deficits and growing national debts, governments scratched their heads to keep needs satisfied and budgets constrained. This is where PPPs

become useful. Neoliberal fiscal rules limit government borrowing, but they do not have such constraints on PPPs. For instance, in Europe there are currently in place specific rules under ESA 2010 that clarify that PPP assets are not included in governments' balance sheets (Eurostat, 2016). The government is in fact committed to paying for the investment just as if the investment had been done directly by the public sector, but the accounting rules allow these payments to be treated as private borrowing (Hall, 2015). Therefore, this is a significant extenuation on budget constraints for governments obsessed with keeping balanced budgets.

The second advantage that PPPs are seen to have is the presumed efficiency of private management. Historically, privatisation has been encouraged based on the argument of comparatively superior efficiency compared to state enterprise (Sykes and Callender, 2009). Structural reasons linked with lack of incentives, lack of competitive environments and lack of skills in the public sector are seen as drawbacks to having a state enterprise. In comparison, the private sector is seen as highly professional, competitive, initiative taking and more innovative. In addition, private management is considered to have advantages regarding time management. In line with the "acceleration hypothesis" the organisational structure of private companies is regarded to have a higher advantage in producing more output for a shorter period. Considering the long-term nature of PPPs, this cost effectiveness in terms of time can be very a crucial positive aspect (Arnold and Kele, 2010). In the UK, the Treasury estimates that the use of PPPs has produced average savings of 17% to 25% over all sectors during the past 10 years (Alfen et al, 2009). This is why the dominating argument put forward by international organisations in support of PPPs has been the economic efficiency argument that helps governments come to the realisation of public tasks more efficiently (Budäus 2005, p. 13 in Arnold and Keele, 2010). Hence, supporters of PPPs discourage a producing state, but instead profess their concentration on providing institutions and suitable regulatory frameworks.

2.3. Problems with PPPs

Before jumping to an empirical analysis of PPPs, it is important to dismantle the theoretical foundations and arguments put forward in support of them starting with the proposition that PPPs reduce pressure on budget constraints. This criterion does not sufficiently hold because PPPs offer a mechanism to pay in periodical instalments what the government would pay in a once-off large sum. So, it is not true that the private firm provides the better school or hospital free of charge by taking a loan from the IFIs. Just like for any other services, the government pays via taxation. In other cases, the PPP is paid via user charges that historically have been higher because of the profit motive. In addition, money is borrowed for the provision of the service by the same financial institutions, be it banks, pension funds or international

organisations. In a similar pattern PPPs sound like mortgage contracts because the house must be paid in the end and the pressure on the family budget is not reduced, but it is just spread over time. In fact, just like with the mortgage, the premium paid for the instalment makes the collective sum much larger than the large upfront sum paid for the project. Moreover, the taxpayer is penalised because of the risk associated with the private enterprise. Although the borrowing rate of the private firm might be very similar to that of a government due to the help by IFIs, a government is in most cases immune from bankruptcy, but a private firm is not. If the private firm in charge of a specific PPP has trouble in other activities, it can go bankrupt and thus penalise the PPP. The World Bank database has numerous records where PPPs were interrupted because of the failure of the private enterprise (World Bank, 2016).

Evidence has also shown that for many projects the actual costs in the end turn out to be much higher than the earlier forecasted predictions. In addition, the actual demand for the service is lower than forecasted. The errors are often made on purpose to legitimise the agreement in the eyes of the public. A clear example are forecasts on road traffic for toll roads, which are always exaggerated. This is not the case only in developing countries, but also in places like the USA, where the actual first-year revenue of 26 toll roads that opened between 1986 and 2004 averaged one-third less than projected (Mildenberg, 2013). These miscalculations lead to difficulties with the returns to the firm in charge, but also in attempts to artificially increase the traffic. In the UK, the total amount of capital investment delivered by over 700 PPPs was estimated to cost about £55 billion, but in the end of the contracts the government is obliged to pay more than £300 billion where £10 billion are said to be paid every year in the first decade. This very large amount of fixed spending that the government is obliged to do every year crowds out the opportunity for funding other public services with that money (Hall, 2015).

A second set of questions should be asked targeting the political governance and regulation of PPPs. Firstly, why do PPPs get such large government support although great debate surrounds them? Most political parties support them and almost always all governments that have an opportunity to go for a PPP they commit. One blunt reason is that PPPs offer governments a way to short term gains (Hodge 2002; Flinders 2005). Although the projects are signed for a very long term, in most democratic countries elections occur every four years. In such little time there is little clear evidence on the efficiency of a PPP. So, the risk of a PPP contract ending in very high costs in the long term and in the deal ending in a Faustian bargain remains difficult to assess (Flinders 2005:224). The case of the Albanian airport is a proof of this. The airport was initially handed to private hands in 2004 under an agreement for a concession of 20 years (Tirana Airport, 2016). A small clause on the deal was that this airport had to be the sole

operating airport in the country for this period. Initially it was presented as a golden deal for the government, because it was offering a new terminal and a modern airport. Due to the signed agreement, 14 years later the airport remains the most expensive in the region, where most flights are to Italy and with a monopoly status there are hardly any low-cost airlines operating through the airport.

In addition, PPPs pave the way for more corruption, because a long-term concession agreement is an opportunity for the current government officials that are in charge of making such a decision to gain a large stream of money in turn for a favour of signing a government backed lease for twenty or more years. There are numerous examples of corruption accusations regarding concessions and in various sectors. For example, in energy, Enron investments in Nigeria and India, and others in Tanzania, Pakistan, Indonesia and Slovakia, which have relied on setting power stations have been associated with corruption (International Energy Agency, 2014).

Finally, the fundamental problem concerning procurement via PPPs has to do with short sightedness of the projects. Even if the assumption that PPPs are better value for money compared to other forms of investment holds, they remain sole projects that are dispersed and that focus on various sectors of the economy. In other words, there is a lack of a grand plan for development or some sort of industrial policy. In the long run it is difficult to see how these help to reach sustained development. Therefore, the following chapter of this paper presents an alternative development strategy to help countries develop in a sustained manner, by putting investment, SOEs and self-determination at the core of the model.

3.0 The Public Investment Alternative

When in search of finding an alternative and superior investment models to PPPs, the starting point would be to look at the opposite of what the Washington Consensus recommend. In this case PPPs are a hybrid between the state and the private sector. However, the genesis of PPPs is based on the idea that the private sector will not undertake investments of the scale that PPPs do, given the risks associated with them. In simple terms, although there might be demand for such investments the supply is scarce if non-existent. Some companies might be able to support such a project financially, but they simply are not willing to do so. The reason is that governments cannot guarantee via contracts that their investment will have positive returns. Therefore, the alternative to be considered remains investment directly from the state and by the state. The latter have become increasingly popular in the part of the world that does not

abide by Washington Consensus recommendations.

The number one example of successful government investment remains China. This model has also been coined with the term Beijing Consensus by Joshua Cooper Ramo (2004). It is based on self-determination and on the state's muscle power to boost the economy and also act as the captain of the ship. This development strategy is flexible enough to not be considered a doctrine³, but it stresses the importance of innovation, the protection of national interests and the idea that to modernise one needs "to grope for stones to cross the river" (Ramo, 2004). In a nutshell, the Beijing Consensus is made of three theorems dealing with the organisation of a developing country. The first one emphasizes the value of innovation; instead of installing old techniques in every corner of the country, there should be bleeding-edge innovation (i.e. instead of copper wires use fibre optic) to bring about fast change and to reduce the friction losses of reforms. The second theorem emphasises the importance of sustainability and equity as paramount to the GDP per capita. Lastly and most importantly, countries should rely on self-determination and not depend on hegemonic powers that dictate the path to development.

Ramo's essay is used as the point of departure here because, as flawed as his analysis may be, the very notion of a Beijing Consensus opens up ways of thinking about the contemporary world situation that are very much worthy of attention. Endogenous development, independent of international pressures is of utmost importance, because imitative Western influenced development strategies do not work, as the countries that abided by the Washington Consensus have shown. In many cases, it is the promoter of the strategy, i.e. the elites and corporates in the Global North that benefit and not the developing country itself. In addition to the Beijing Consensus that emphasises self-determination, strong attention should be paid to investment as the driving mechanism to development. This is where industrial policy becomes very useful, also as the escape from dependency on other economically superior countries. Industrial policy is thus the link between the Beijing Consensus and post Keynesian economic theory, as the foundations of an alternative development conception to be presented below.

3.1 Why Investment is a Priority

Developing countries often face the problem of running low on productive capacities, meaning that there is an ample labour force which cannot be employed given the scarcity of capital goods. As a result, high investment is required to increase employment as well as the standard

³ In fact, the Beijing Consensus has not been recognised by Chinese authorities on the basis that it is a Western conceptualisation of its economic and political situation.

of living. Investment also accelerates growth in productive capacities and increases overall national income. Developing countries thus do not face the problem of future unemployment that advanced economies have with increasing capacity. This argument is in line with post Keynesian economic theory, in particular with Kalecki's argument (1966) of insufficient effective demand being problematic for developed countries but not so much for developing ones, simply because of a large pool of labour force being unemployed. The problem is not with effective demand, because in the Keynesian sense there might be full employment, but there is high underutilisation in terms of the maximum capacity of capital stock is insufficient to employ the labour force in full (Dasgupta 1954). The lack of capital stock is also seen in low developed countries where employment is high but the number of people living in poverty is also very high. In this case the output of the employed is of a very low value, resulting from the low level of skills and productivity. In this case, most people are employed in the agricultural sector and not so much in the industrial sector, so they are employed not so much for wages but for produce.

In addition, in countries that are behind in the development path and that have strong social flaws, it is redundant to require strict fiscal restrictions. These countries cannot afford to have balanced budgets because they need to invest in their economies in order to advance. Cross country analysis has shown that well designed and strategic public expenditure is fundamental for the encouragement of economic growth and the reduction of severe social problems. Numerous studies have shown that public investment in sectors like health services, education, transportation and other sectors is strongly linked with growth and poverty reduction (Easterly and Rebelo, 1993).

While Williamson might be right in arguing that a full set of prescriptions is important to boost the economy, investment should be the number one priority. After investment is assured officials should worry about following the Washington Consensus and even then, with selectivity. If markets are left to work their magic and if the Washington Consensus policies are applied, multinational corporations shift their production in developing countries. Instead of helping them fill in their gaps in productive capacity, these MNCs bring their own workers and hire only the top qualified from the pool of domestic workers, which in fact increases the gap between the skilled and unskilled, instead of just increasing the number of skilled workers. The less skilled are thus left to work for domestic companies that cannot compete with the MNC to begin with. Therefore, the Washington Consensus policies do not help developing countries, but rather help reinforce the current capitalist system based on the exploitation of developing countries or firms by developed or international firms.

The alternative development strategy proposed in this chapter should be seen as preceding the Washington Consensus. An important aspect of this framework is that the strong hand of the state in the model is crucial and unquestionable. Even if the focus of the state might vary across industries, its tools remain the same. States use state owned enterprises (SOEs) to implement restructuring plans.

3.2 The Case for SOEs

Investment is at the core of a country seeking to develop but finding the right strategy of investment is a difficult task for most governments. While PPPs take the burden off budget constraint, at least temporarily, they remain isolated projects. Therefore, the solution is direct state involvement in investment strategies via an SOE. This is a legal entity where the state or the government has at least 50% of ownership stake. State ownership can be expressed in various forms, but most frequently the state will take equity in corporate enterprises or create a statutory corporation governed by a status outlining objectives and requirements through legislation (Kowalski et al, 2013). SOEs have existed since the creation of the state as a notion and an entity. They are frequently used everywhere in the world, even in countries with a large focus on private enterprise. There are numerous reasons why even economies like the US rely on SOEs to provide certain goods and services. Occasionally, SOEs are created to kickstart an economy where private enterprise is weak because domestic capitalism has just started. In other cases, SOEs are the result of historical and political settings arising from post-colonial societies or socialist governments. Most often SOEs exist to correct market failures, especially in countries with weak legal frameworks. They provide a public service like water and electricity or they correct negative market externalities etc. For this paper, SOEs are proposed as the best way to invest in the same cases where PPPs are used, i.e. to invest in long term projects for which private enterprises cannot and would not invest.

Apart from the critical points for PPPs in part 2.4, which coincidentally speak in favour of SOEs as the alternative, the clearest advantage that SOEs have in comparison to PPPs is the direct involvement of the state. This argument might appear bizarre considering that one of the Washington Consensus arguments for PPPs is the removal of direct state control. However, what they overlook is the role of the state as a coordinator of the whole economy and that it can act as the manager of a master plan for long run and sustained development. This is done through industrial policy to foster industries that are economically desirable but cannot be

developed through private investment ultimately restructuring the economy⁴. Industrial policy should be seen as a complement to market forces and not as a replacement, because in fact this policy strengthens the efficient allocation of resources. As Rodrik (2004) argues, industrial policy is about extracting information from the market on where the problems rest as well as in trying to fix these problems with appropriate policies and investment. Thus, it is more important to get the right information on the flaws of the market than the policy outcomes in themselves. Rodrik argues that policymakers should worry about getting the private sector to cooperate with the public actors to solve problems with productivity and he sees much of industrial policy as a discovery process. Firms and the government learn about costs and opportunities in the economy and coordinate strategically. The ultimate purpose is to restructure the economy and discover a different way to produce something cheaply at home with the given technology and resources. This gives one's economy an advantage to the competitor abroad. For example, Taiwan found a way to restructure its economy into becoming the biggest world producer of orchids. Other examples include garments in Bangladesh, salmon in Chile and IT in India. Self-discovery is easier done when there are lower barriers to entry and the cost of government regulations of entering the market are low (Klinger and Lederman 2004). If this self-discovery process is coupled with a market where a large part of enterprise is in the form of SOEs, reading the market and getting the right information becomes much easier, even compared to the PPP model.

The second argument for industrial policy is somewhat in line with the PPP argument, i.e. that there should be coordination in the economy between producers to help each other in vertical integration. The classic coordination problem is when profitable new industries do not develop unless upstream and downstream investments are developed simultaneously. In other words, industrial policy can be used to help infant industries grow, in order to support current developed industrial sectors in the economy. This is where the role of the government is crucial as it helps organise the economy by providing support for the infant industry. The government can decide which firm does which investment in order to coordinate so that all investments become profitable simultaneously. It is thus easily seen that in the case of SOEs this role of the government is easily pursued and followed. With PPPs coordination is more difficult because private investors will only choose to invest wherever they see profitability and not where the government feels it is best suited for them to invest. Unless they receive a guarantee from the government (i.e. subsidy or advance payment) that their investment will pay off, private firms will be unwilling to take part in a PPP. These partnerships thus remain one off

⁴ In this paper industrial policy will be used in line with Rodrik's argument that industrial policy is as much about making explicit the market failures in the economy as is correcting them.

projects with a short-term focus and can hardly be a part of a “master plan” by the government to restructure.

History and empirical evidence have shown that the best performing developing countries in the world are those that are highly interventionist and that do not rely on the free market to work its magic. Convergence with developed countries through neoliberal policies is continuously contested on an empirical level, except for the above theoretical argument. It is in fact the institutional and policy divergence across countries that emphasises the importance of pursuing individual remedies to economies in crisis or failing to catch up. The most quoted example of this case is East Asia, which has used heavy state intervention in the economy to strengthen and develop. More precisely, Japan, Taiwan and South Korea have used industrial policy to determine export growth, to increase local R&D capabilities as well as lower imports and depend more on the domestic economy (Chang and Grabel, 2004). These types of policies have been applied elsewhere in the world as well. For instance, Chile has continuously applied non-recommended policies such as subsidies for export industries or heavy capital controls in the 1990s (ibid.). Indeed, it was one of the very few countries in Latin America that managed to perform well economically in the 1990s (Rodrik, 2002).

History also teaches us that even what are now developed countries have throughout time depended on numerous state intervention policies to boost their economies, be it industrial or financial policies. France, Japan, Norway, Finland and even the US have continuously used industrial policy to rebuild and restructure their economies after WWII. What are now considered developed countries have been in a developing stage previously and have used industrial policy. So it seems counterintuitive for international institutions located in the advanced economies to recommend to developing countries the abolishment of any protective policies against free trade or any subsidies to enhance exports. These developing countries are in a lower stage of development very similar to that experienced by now advanced economies⁵ (Kreisler, 2012). A crucial point to be made is that industrial policy is not anti-market and against capitalism. Through industrial policy the state gets involved in the economy by selectively controlling market forces in order to enhance the national competitiveness in the world market. It is neither done to replace private firms with SOEs, nor to place more power in the hands of the state.

When countries are developing, innovation and productivity increases should go in parallel ways. Therefore, industrial policy should be combined with demand management. It implies

⁵ There are some differences arising from technological advances especially in the financial sector.

sufficient domestic demand for consumption which in turn heavily depends on income distribution patterns in the country. SOEs have an upper hand compared to PPPs in terms of managing and analysing the aggregate demand components more efficiently. In addition, they can be a tool for controlling the volume and the structure of aggregate demand thoroughly. The latter works based on a specific economic structure that translates the aggregate demand into specific demand for particular products that are produced by specific workers in a specific manner, as Minsky (1968) and others have argued (Galbraith 1970; Robinson 1972). By using policy to influence the economic structure, in other words by using SOEs, the aggregate demand can play an important role to improve income inequality. If SOEs play an important role in investment and are used for industrial policy in countries where unemployment is very high, the government can directly increase the wage share in the production processes. Through SOEs the government can easily employ the unemployed and improve the income share at the bottom of the strata, improving overall the labour income distribution. This is beneficial not only because it lowers the unemployment level, but also for further encouragement of investment and increase of the aggregate demand. As Kaldor has argued (1959), this is due to the propensity to save out of wages being lower than the propensity to save out of profits. Keeping in mind a post Keynesian framework, this means that if workers have more money to spend because of higher income, they encourage higher investment and higher aggregate demand driven by their consumption. As Minsky has argued (1968) the demand for low wage workers should encourage the demand for high wage workers and not vice versa. In this way, SOEs help to institutionalise long term unemployment and income inequality, which ultimately helps in reducing overall poverty levels (Minsky, 1965).

When a country pursues industrial policy, the government has to make sure that it is done on a national level. The failure to do so is clearly noticed in the case of Vietnam where the egoism of provinces does not allow the country to escape its position in the global value chain (Herr et al. 2016). Economic policy has to be centralised to include interministerial coordination schemes both at the local and national level. Having SOEs helps the process of coordination for industrial policy much more than having PPPs, simply because private actors have strong profit motives, whereas the government has long term development motives and the two can be in conflict, especially in the short run.

3.3. Flaws in SOEs

At the same time SOEs are often with reason seen in a bad light. Neoliberalism's nemesis are SOEs largely because they imply the need for a big and controlling state, or in the words of Hobbes' "the Leviathan state" (1651). To comply with industrial policy a government should be very far sighted. In democratic countries political actors have to be confirmed in office every four years and they are pressured to provide results fast enough to assure them re-election. Thus, SOEs are a double-edged sword in terms of offering a better management of the macroeconomy and development, but at the expense of risking democracy. China is indeed the poster child of very successful SOEs, but China is an autocratic state and officially a communist state. The second problem with SOEs is that the government is not made of philosopher kings (Plato. and Lee, 1974), i.e there is no guarantee that the government is well equipped to "pick winners" (Rodrik, 2004). The government is often seen as inefficient and corrupt and ultimately unable to choose which is the area where the economy should focus in order to develop. In many post-communist countries there exists a phenomenon of "buying the job" (Herr, 2016), where an individual gets the civil servant status by paying someone in the position for taking that decision. With the lack of meritocracy, it becomes very hard to put competent managers in charge of SOEs.

Another risk of having large public investment combined with inefficient governments is that of a debt crisis. A recent study by the IMF (Warner, 2014) has shown that initially large public investments have positive effects in the economy, but after some time diminishing marginal returns kick in. The economic returns start to fall and as money dries up a debt crisis emerges. This is true mainly for governments with deep incentive problems, agency problems, a pervasive avoidance of rational analysis and even difficulty obtaining or collecting the critical data that would underpin rational investment choices. Previously rejected projects have the advantage of having been analysed once and can be implemented quickly at the cost of not being the best option for investment. Another reason for the failure of public investment to be positive in the long run is that when money is loose, government officials tend to be more lavish in their investments and are not careful enough (ibid.). They are also easily influenced by lobbying groups. If suddenly the government decides to increase investment, it will pick off the shelf that project that was rejected initially on grounds of low impact. Therefore, the success of public investment depends on local conditions. It has worked for many countries for decades, like in Ethiopia and it has encouraged private enterprise in India, but it has also led to a massive debt crisis in Latin America in 1980s. In order to avoid a debt crisis, the government has the option of funding its own spending via tax revenues, which would have to be large enough to sustain significant investment levels. Otherwise, the government would have to

increase and expand its tax base at least for the short term. This would levy the burden of indebtedness from the government as well as the dependency on third parties as a result of the debt leverage. However, increasing tax bases is very unpopular with many societies and would require changing mentalities of citizens towards taxation. Without citizens being willing to pay higher taxes by believing that it will benefit them in the long run, the government runs the risk of encouraging corruption, grey markets and tax evasion.

4.0 Empirical Evidence

Firstly, there have been no meta-analysis or regression analysis measuring these forms of investment in a comparative way as of yet. So far, PPPs are chosen based on an assessment of “value for money” as compared to the traditional way of procurement. For example, in Germany the government uses the Public-Sector Comparator, which is a quantitative comparison of the net present value of all costs incurred during the intended contract period, i.e. for design, construction, finance, maintenance, operation etc. for the traditional (PSC) and the PPP option (Alfen et al, 2009). In other cases, there is no comparison done a priori, but it is proceeded just with the PPP, as a state audit office report showed in Estonia (Friedrich and Reiljan, 2007). In the UK, comparisons between the traditional procurement and the PPP are often over looked . It has thus created a false impression that there is no alternative better than a PPP, given the reluctance to increase budget deficits or taxes. In academia, the closest study similar to this paper is the one done by Burger and Hawkesworth (2011) who look at the comparison of “value for money” for traditional procurement versus a PPP. However, they look at the factors that skew the choice decision either for a PPP or an SOE and not at the final outcomes in the long run. The rest of the empirical studies focusing on PPPs have almost always a “firm based” perspective. The staff of the U.S Department of Treasury has also released a study of PPPs, precisely with suggestions on how to increase the rate of return on these investments (Buckberg et al, 2015). Grimsey and Lewis (2002he) have dealt with evaluating the risk associated with the success of a single PPP. The success and the result of the PPP in economic terms, especially on a macroeconomic scale has so far not been measured. It is simply assumed that infrastructure investment is positive for the economy and the more the merrier. From a financial cost ex ante PPPs have an advantage as it was shown in chapter 2. But once the long-term effects measurement is considered, the matter becomes very complicated. What follows is a simple empirical analysis aimed at precisely this long-term matter⁶.

⁶ Given various constraints when writing this paper, this analysis should be taken with a pinch of salt. One of the reasons it is done, is that mainstream theorists are very keen on empirical research. By providing evidence against their

4.1. Data Description

In this piecemeal attempt to compare the two methods on a macroeconomic level, this paper will look at data mainly from the World Bank and data processed by the Federal Reserve of St. Louis, although their data also originates from the World Bank (2017a). The choice is mainly reflective of the fact that this paper focuses on developing countries. The sample dataset includes in total 98 countries⁷, over a period of 16 years, from 2000 to 2015. Countries with no data on PPPs have also been excluded from the dataset. GDP per capita is used as a measure of the success of the investment, be it by an SOE or by a PPP. This is why GDP per capita expressed in US dollars is used as the independent variable⁸. Credit to GDP from SOEs as a percentage of GDP is used to measure the SOE effect in the economy. The average rate of credit to SOE to GDP out of 1105 observations is 9.3%, with a minimum of less than 0.5% and a maximum of 74% in Liberia in 2010, which in itself is a one-off value given the political situation at the time. As in theory, PPPs are used as a good way for debt relief from the government side, this paper uses central government debt as percentage of GDP (sPD) as one of the explanatory variables. Public debt as a share of GDP in this group of countries averages around 44%, with the lowest value being 4.6% in Azerbaijan in 2008 and the highest value is 127.7% in Jamaica in 2002 (World Bank, 2017b). However, for most countries data on this variable is missing. In total there are only 361 observations of public debt levels as a percentage of GDP. These observations are for only 40 countries, as for the rest there was no consistent World Bank data. Another explanatory variable considered for this estimation is corruption control as measured by the World Bank⁹. This value is also expressed in percentage in an ascending order. The higher the percentage the more efficient is the government in controlling corruption and the lower is the corruption level perceived by citizens. In this

claims they might be more convinced than simply on theoretical claims.

⁷ Albania, Algeria, Angola, Argentina, Armenia, Azerbaijan, Bangladesh, Belarus, Belize, Benin, Bolivia, Bosnia Herzegovina, Botswana, Brazil, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Central Africa, Chad, China, Colombia, Costa Rica, Cote D'Ivoire, Djibouti, Dominican Republic, Ecuador, Egypt, El Salvador, Gabon, Georgia, Ghana, Guatemala, Guinea, Guinea-Bissau, Haiti, Honduras, India, Indonesia, Iran, Iraq, Jamaica, Jordan, Kazakhstan, Kenya, Kyrgyz Republic, Lebanon, Lesotho, Liberia, Macedonia, Madagascar, Malawi, Malaysia, Maldives, Mali, Mauritania, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Panama, Paraguay, Peru, Philippines, Romania, Russian Federation, Rwanda, Senegal, Serbia, Seychelles, Sierra Leone, South Africa, Sri Lanka, Sudan, Syrian Republic, Tajikistan, Tanzania, Thailand, Tunisia, Turkey, Uganda, Ukraine, Venezuela, Vietnam, Yemen, Zambia, Zimbabwe

⁸ GDP growth was also considered as the independent variable for the model, but the results were insignificant. It was then considered as explanatory, but with no success either.

⁹ "Control of Corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. Percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to lowest rank, and 100 to highest rank. Percentile ranks have been adjusted to correct for changes over time in the composition of the countries covered by the WGI (World Bank, 2017c).

sample, Botswana has the highest level of corruption control, with an average of 80.6% from 2002-2012 and the lowest performing country is Zimbabwe, with an average of 4.3%.

The most difficult variable is that concerning the estimation of the success of a PPP. In this case data from the World Bank Private Participation in Infrastructure Database has been used (World Bank, 2017d). This was the most reliable data to be found, but unfortunately data is limited to only infrastructure projects. They include records on infrastructure projects that have reached financial closure, in which the private party has assumed all operating risks. The data includes investment as stated at the beginning of the project (at contract signature), not in the middle or the end. Although the database is very large, this paper takes into account only projects where there is full private party control. The World Bank dataset shows individual projects, so for this paper, each project has been summed up according to the year the contract was signed and the country where it is applied. In this way, this paper collects all PPI data for one year in one given country. Then, each of these values is calculated as a percentage of GDP as the World Bank data is expressed in millions of US dollars. For example, Brazil is one of the countries with the highest PPI investment with an average of 57 PPI projects in a 15-year period. The average share of GDP for a PPI is 1.5%. For some countries it can go as high as 8% (eg. Serbia in 2006). On the other hand, more than half of the countries in this dataset have less than 5 PPI projects as an average of the years considered. The assumption for this estimation is that the higher the value of the investment the higher is the benefit for the society as a whole, and for this paper that is expressed as GDP per capita. So, the higher the PPI project as a percentage of GDP the higher the effect on GDP per capita. In other words, the coefficient of the PPI variable should be positive. The same is expected from the SOE and from the corruption control variables. On the other hand, the coefficient for the public debt variable remains debatable. Neoliberal economists argue that the higher the public debt level the worst is for the economy as a whole and as such the lower is the GDP per capita. Heterodox schools of thought beg to differ arguing that government investment is necessary in cases of recession and in these cases a high public debt level is beneficial for reviving the economy. The correlation between GDP per capita and GDP growth remains uncertain as well. If an economy grows fast that can mean higher GDP per capita. However, if that extra income increases inequality between the rich and the poor, that can have a negative effect in the long run. In addition, developed countries have slower growth rates but high GDP capita. This is due to the fact that developed countries operate close to full capacity (see section 3.2.) and there is not much room left for very speedy growth. On the other hand, developing countries have underutilisation, which allows them to have high growth rates so the overall effect of GDP growth on GDP per capita remains unclear.

4.2. Methodology

The compilation of the dataset has a total of 1145 observations and it is a panel dataset. After running the LM test to decide whether to use simple OLS or another estimator¹⁰, it appeared that the simple OLS estimator was insufficient, as the data showed heteroskedasticity was present. In this case, it was considered using fixed or random effects estimation. The Hausman test with the null hypothesis that the error term is uncorrelated with the regressors shows that in fact the null hypothesis is rejected. This means that for this estimation random effects estimators are better suited as compared to fixed effects estimation. This is why for this paper, the random effects generalised least square (REGLS) method of estimation is used. Random effects estimator is used when it is believed that unobserved effects are uncorrelated with all the explanatory variables and are different to the error term (Wooldridge, 2013). If a good model is used for the estimation, heterogeneity only affects the error term, but it does not cause correlation between the error term and the explanatory variables¹¹. The error term expressed as u_{it} captures all unobserved factors that change over time and affect the independent variable. As time varies in the data, to keep the consistency of the variables through time, the t subscript is used next to the variables. For consistency of the data for the same country, the term i is used as a subscript. The term a_i captures, instead, all unobserved, time-constant factors that affect GDP per capita.

In addition to taking into account random effects and heteroskedasticity, time lags are used for the regressor of sPPI. While this explanatory variable captures the total monetary cost of all PPI investments per country in a given year, as a percentage of that year's GDP, it is hard to estimate the effect of this investment in time. This is why time lags for three years are used in this estimation. In other words, the effect of the investment of a PPI today can be estimated for the effect on GDP per capita three years from now. The lags can be extended, but that would be with the cost of losing observations, considering that for many countries the dataset is not in a consecutive time period. When the three-year lag is used the total observations drop to 275.

The models presented in this study may be subject to reverse causality; therefore, future models testing joint probability and lagged effects on explanatory variables could provide greater insight on causation and interdependence of variables. This in addition for more efficient functional forms will not completely avoid the reverse causality problem, but it can mitigate it.

¹⁰ Prob > chibar2 = 0.0000

¹¹ The Hausman test for the regression with sPPI, sPD, Corruption and sSOE showed that Prob>chi2=0.3705. As the result is more than 0.05 we use random effect

The regressions that are used for the estimation are the following:

The basic model (M1):

$$\text{GDPcapita}_{it} = \text{sPPI}_{it} + \text{sSOE}_{it} + \text{sPD}_{it} + \text{Corruption}_{it} + u_{it} + a_i$$

The model with the three-year lag (M2):

$$\text{GDPcapita}_{it} = \text{L3PPI}_{it} + \text{sSOE}_{it} + \text{sPD}_{it} + \text{Corruption}_{it} + u_{it} + a_i$$

The original model and the added three year lag as added explanatory variables (M3)¹²:

$$\text{GDPcapita}_{it} = \text{sPPI}_{it} + \text{L3PPI}_{it} + \text{sSOE}_{it} + \text{sPD}_{it} + \text{Corruption}_{it} + u_{it} + a_i$$

4.3. Results

M1:

```

Random-effects GLS regression              Number of obs   =       344
Group variable:  country1                 Number of groups =        46

R-sq:                                     Obs per group:
  within = 0.1082                          min =           1
  between = 0.2265                         avg =           7.5
  overall = 0.2191                         max =           15

corr(u_i, X) = 0 (assumed)                 Wald chi2(4)    =       23.36
                                           Prob > chi2     =       0.0001

                                           (Std. Err. adjusted for 46 clusters in country1)

```

GDPcapita	Coef.	Robust Std. Err.	z	P> z	[95% Conf. Interval]	
sPPI	-10.55475	3.807852	-2.77	0.006	-18.01801	-3.091503
sSOE	96.3562	32.37258	2.98	0.003	32.90711	159.8053
sPD	-42.40026	20.93835	-2.03	0.043	-83.43867	-1.361842
Corruption	29.0308	16.68829	1.74	0.082	-3.677644	61.73924
_cons	3904.668	1680.482	2.32	0.020	610.9839	7198.353

Fig. 1: Stata output for the M1 estimation, author's representation.

In the first model, it is immediately noticed that Corruption is insignificant, given the high p-values. Out of all the observations, given the unbalanced dataset, only 344 observations remain out of 46 countries. In addition, sPD is significant at the 5% significance level. The coefficient is in line with the mainstream theory that public debt is negative for the economy. What is of

¹² Other regressions were also tried out. For example, GDP growth was included in M2, but the model became altogether insignificant. In addition there were other time lags for PPI that were considered, namely lag for year one and year two. However, the regression did not improve.

interest is that sSOE has a positive coefficient, although much higher than expected. The coefficient for sPPI is negative and significant. This means that the higher the investment the worst is the effect on GDP per capita. This seems to fit the theory proposed in this paper, that SOEs are beneficial to the economy and preferred to PPIs. The explanatory power of this regression (R-squared) is 22%. The model, however, is quite limited and this explains the very large coefficients and the large constant.

M2:

```

Random-effects GLS regression           Number of obs   =   275
Group variable: country1              Number of groups =   38

R-sq:                                  Obs per group:
  within = 0.0748                       min =          1
  between = 0.2201                      avg =         7.2
  overall = 0.1818                      max =         13

corr(u_i, X) = 0 (assumed)             Wald chi2(4)    =   68.02
                                          Prob > chi2     =   0.0000

                                          (Std. Err. adjusted for 38 clusters in country1)

```

GDPcapita	Coef.	Robust Std. Err.	z	P> z	[95% Conf. Interval]	
lag3PPI	5.444844	1.667623	3.27	0.001	2.176363	8.713325
sSOE	105.5476	36.04852	2.93	0.003	34.89377	176.2014
sPD	-34.53831	12.85786	-2.69	0.007	-59.73925	-9.337378
Corruption	19.99671	20.63067	0.97	0.332	-20.43865	60.43208
_cons	3932.71	1416.323	2.78	0.005	1156.767	6708.652
sigma_u	2719.9646					
sigma_e	1460.5075					
rho	.77620215	(fraction of variance due to u_i)				

Fig.2: Stata output for the M2 estimation, author's representation.

When the three-year lag is added to the regression, the first thing to notice is that the sample becomes smaller. There are now only 275 observations for 38 countries. The positive side is that only Corruption remains insignificant. With this model, the effect of sSOE on GDP per capita remains positive. The effect of sPD is confirmed to be negative. So, a higher GDP per capita is associated with a lower level of public debt. The explanatory power in this case drops slightly to 18%. The constant remains very high and this is understandable, considering the many factors that can influence GDP per capita which are left apart in this paper. What is of interest here though is what happens with the PPI variables. The effect of sPPI also remains

negative, although now it is much smaller. The L3PPI remains significant at the 80% confidence level, but it has a positive sign. This means that in the medium run PPIs become positive.

M3:

```

Random-effects GLS regression                Number of obs   =    275
Group variable: country1                  Number of groups =    38

R-sq:                                       Obs per group:
  within = 0.0759                          min =          1
  between = 0.2261                         avg =          7.2
  overall = 0.1903                         max =          13

corr(u_i, X) = 0 (assumed)                  Wald chi2(5)    =    68.72
                                              Prob > chi2     =    0.0000

```

(Std. Err. adjusted for 38 clusters in country1)

GDPcapita	Coef.	Robust Std. Err.	z	P> z	[95% Conf. Interval]	
sPPI	-8.426275	2.877937	-2.93	0.003	-14.06693	-2.785623
lag3PPI	3.682524	1.580895	2.33	0.020	.5840276	6.781021
sSOE	105.0767	36.31032	2.89	0.004	33.90975	176.2436
sPD	-35.17662	13.20371	-2.66	0.008	-61.05541	-9.297824
Corruption	20.23567	20.82477	0.97	0.331	-20.58013	61.05147
_cons	3976.595	1423.457	2.79	0.005	1186.671	6766.519
sigma_u	2763.9658					
sigma_e	1462.8913					
rho	.781171	(fraction of variance due to u_i)				

Fig.3: Stata output for the M3 estimation, author's representation.

When the three-year lag is added to the original regression the sample remains at 275 observations for 38 countries. The positive side is that only Corruption remains insignificant. With this model, the effect of sSOE on GDP per capita remains positive. The effect of sPD is confirmed to be negative. So, a higher GDP per capita is associated with a lower level of public debt. The explanatory power in this case is 19%. The constant remains very high and this is understandable, considering the many factors that can influence GDP per capita, which are left apart in this paper. What is of interest here though is what happens with the PPI variables. The effect of sPPI also remains negative, although now it is much smaller. The L3PPI remains significant at the 80% confidence level but it has a positive sign. This means that somewhere in the medium run PPIs turn to have positive effects on GDP per capita.

Out of these three models, the best remains M2, which takes into account only the three-year

lag to capture the effect of PPIs on GDP per capita. It is interesting that for the first three years of the PPI investment the effect to GDP per capita remains negative. Only after the third year the investment starts to have a positive effect on GDP per capita. However, the coefficient of the effect of the PPI on GDP per capita after three years since the project has started is 5.4, meaning that a one percent increase in the PPI value as a share of GDP increases the GDP per capita by 5.4%. On the other hand, the coefficient for the variable of SOEs is 105.5, which means that if the returns to government from SOEs increase by one percent, the return to GDP per capita increases by 105.5 percent. Clearly the coefficient is somewhat exaggerated, because the available data for SOEs is not restricted just to those that deal with infrastructure projects, but it is for all industries. Also, at this period in time, PPPs still are very small relative to GDP. Nonetheless, their effect is less positive than that of SOEs. Considering that the average credit to GDP from SOEs is 9.3% and considering that the average PPI as a percentage of GDP is 1.5%, the coefficient of lag3PPI (which indirectly measures the return from the PPP) is multiplied by 7.8 and it becomes 42.12. This shows that even if PPIs had the same value as percentage of GDP as the credit from SOEs, their effect to GDP per capita would still be smaller. Finally, corruption control is insignificant, which shows that the model is not perfect. Removing this variable distorts the model, which shows that there are causality issues that remain unidentified.

5. Conclusion

Firstly, this paper has presented a strong critique against the Washington Consensus recommendations, but it should be noted that not all reforms are bad. For instance, the importance of property rights for the well running of an economy cannot be antagonised. Institutional building, although added later, is undeniably very important as a base for well performing countries. The importance of this was seen also in part 3.3 where it was noted that weak governments can easily produce weak investments and can heavily in debt their countries. In fact, China, which is the model country for the Beijing Consensus, adheres to most of the Washington Consensus recommendations (Qasem et al, 2011). Yet, stressing that deregulation and privatisation lead to development, while neglecting the importance of investment as a top priority for countries to develop is not the solution. By offering a package deal Williamson completely ignores the importance of aggregate demand as a stimulus for the economy. He also ignores income distribution and the historical and institutional conditions prevailing in developing countries. In addition, Williamson has recognised that investment is a large component towards development.

The theory provided in this paper has strongly been in support of direct state investment as a better alternative to development than investment via PPPs, as the tools used by the Washington Consensus. Table 3 presents a summary of the main arguments used for and against both cases. Almost all arguments in support of PPPs have been questioned in their validity. While SOEs have many arguments against them, the help that SOEs give to industrial policy applications and income distribution are superior to budget constraints relief and stronger customer orientation. But the issues around SOEs cannot be ignored either. Hence, there are two important conditions for SOEs to function well: good governance and exclusivity. In order to eliminate the corruption tendencies, cronyism and nepotism, all of which go against the efficient workings of an SOE, there should be a strong supervising mechanism set in place. Monitoring the work of an SOE by requiring transparency and frequent reporting reassures tax payers and builds the trust in the government. In the best cases monitoring can be conducted by an external auditor who could be given the responsibility for researching and reporting on the implementation of the SOE project. In addition to monitoring, there should be legislation specifying how an SOE must operate and explicitly state the role of the government and all the structures of an SOE. There should be strong regulation on handling complaints received against SOE operations to ensure that the SOE is complying with its obligations and to avoid fraudulent behaviour. Secondly, the government should not perform activities that are already present in the economy and to try to do them a little bit better. The government should perform tasks and invest where nobody at present is doing anything (Keynes, 1926). In the case they find an unexplored territory, they should carefully analyse the prospects for future investments and when faced with the choice of an SOE or a PPP to undertake the project they should choose an SOE as confirmed by the empirical results. In this way the size of the state is also kept on reasonable levels and the risk of an authoritarian government is reduced. The fundamental point is that PPPs result being better short-term solutions and SOE investment seem more suited for countries seeking to grow sustainably.

The empirical findings are interesting, and they should be used to encourage further thorough research. The model can significantly be improved by adding more variables as a start. In addition, more countries can be included. There is much more available data on developed countries who have used PPPs for a much more extended period than developing countries. The available data for the former is more reliable and greater as well. Furthermore, there should be better indicators of progress, apart from GDP per capita. Other models can be based on income distribution improvements combined with GDP per capita.

Finally, one should be open to a hybrid model, i.e. corporate SOEs managed by private actors

chosen by the public. One proposal brought forward by Rodrik (2008), is the co-financing facility to subsidize the cost of self-discovery. By organising a contest in which the private sector proposes potential investment proposals and offers a bid for public resources. The proposals would have to be based on new and sustainable activities, similar to the industrial policies discussed in chapter three.

This paper has focused on development paths for countries lagging behind the so-called developed countries. It was argued that in order to push for privatisation and avoid public opposition, international institutions have found a solution in PPPs. They remain imperfect models because they increase income inequality and corruption incentives. In addition, on a large and long-term scale, they remain limited in the opportunities they offer for the long term sustained development. As an alternative to the Washington Consensus this paper has argued for a model based on investment and self-dependency with combining elements from post-Keynesian theory as well as the Beijing Consensus. The alternative rests on the importance of industrial policy as the tool to achieve independence from western powers as well as to increase investment that is fundamental for developing countries. To accomplish industrial policy, instead of PPPs the government has to use SOEs as the entities through which investment can be carried forward. SOEs are superior to PPPs precisely because they focus on the long run development prospects of a country without being short term profit driven. Through an empirical analysis based on a regression model, this paper was able to provide some evidence that SOEs are superior to PPPs not just in theoretical terms. Finally, the paper has presented some flaws of the analysis as well as some room for further empirical research.

Table 3. PPPs and SOEs compared, author’s representations.

	Benefit	Costs
PPPs	<ul style="list-style-type: none"> ● Cheap borrowing ● No budget constraints for governments ● high efficiency ● stronger customer orientation ● low transaction costs 	<ul style="list-style-type: none"> ● risk of bankruptcy ● more expensive in the long run ● increase in income inequality ● spurious investments ● encouraging corruption
SOEs	<ul style="list-style-type: none"> ● industrial policy ● demand management ● avoidance of principal-agent problems 	<ul style="list-style-type: none"> ● risk of authoritarian state ● inability to “pick winners” ● nepotism and leniency ● debt crisis

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