Don't Trust Technocrats
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Economic policies are not neutral, but ideological - and populist resistance to them is a rational response

Developing countries are often advised (or instructed) to undertake reforms recommended by "experts" who are called "technocrats" and are often backed by the IMF. Opposition to the reforms is usually dismissed as "populist". Countries that fail to undertake these reforms are dismissed as lacking political will, and soon suffer the consequences: higher interest rates when borrowing abroad.

But many of these "technocratic proposals" are more often based on ideology than economic science. Technocrats can, of course, make an electricity plant work better - to produce electricity at as low a price as possible. This is mostly a matter of engineering, not politics. Economic policies are usually not technocratic in this sense. They involve trade-offs: some may lead to higher inflation but lower unemployment; some help investors, others workers.

Economists call policies where no one can be made better off without making someone else worse off "Pareto efficient". If a single policy is better than all others for everyone, it is said to be Pareto dominant. If choices among policies were purely Paretian - ie if no one was made worse off by choosing one policy as against another - the choices involved would indeed be purely "technical".

But few policy choices are Paretian. Instead, some policies are better for some groups, but worse for others. In East Asia, for example, IMF bailouts helped international lenders, but hit workers and domestic firms hard. Different policies might have imposed more risk on lenders and less on workers and domestic firms. Deciding which policy to choose involves choices among values, not just technical questions about which policy is in some morally uncontroversial sense "better". These value choices are political choices, which cannot be left to technocrats.

Of course, there is scope for technical analysis even when political choices are at the crux of the decision. Technocrats can sometimes help avoid Pareto inferior policies, that is, policies that make everyone worse off. The problem is that many policies advanced by technocrats as if they were Pareto efficient are in fact flawed and make many people - sometimes entire countries - worse off.

Look at the litany of technocratically inspired examples of privatization and deregulation in the 1990s. Banking "reform", for example, frequently required government bailouts, leaving a few people much richer, but the country much poorer. These failures suggest we should have less confidence in the supposed skills of technocrats - or at least less confidence than they have in themselves. But there is also a more fundamental point. Democratic processes are likely to be more sensitive to the real consequences of policies, to the real trade-offs involved.

Of course, some criticisms of technocratic remedies may be populist posturing, but sometimes they contain insights that ivory- towered (and usually US-trained) technocrats miss. Consider the case of Mexico, where a proposal to raise revenue by taxing food and medicines consumed by the poor was, unsurprisingly, rejected by a democratic legislature. Rejecting this proposal was not a matter of unbridled populism. The problem was with the proposal. Its advocates argued that efficiency required adopting a value added tax. Advanced industrial countries in Europe use such a tax. Developing countries, the technocrats said, should do likewise. But there is a fundamental difference between developed European countries and emerging markets: the size of the informal sector, from which VAT is not collected. This vast "black economy" makes VAT inefficient in most developing countries. Indeed, because VAT is a tax on the formal sector whose incomes and expenditures can easily be traced (as distinct from those of the cash-based street vendors, village enterprises and poor farmers) - VAT impedes development.

Developing countries that impose VAT perversely encourage production to remain in the informal sector. But it is the formal sector that produces higher value-added manufactured goods that compete with developed countries. There are other sources of tax revenue in many developing countries that are both more equitable and distort economic incentives far less than VAT. Many developing countries lack a corporate income tax. It may also be possible to impose taxes on luxury goods (many of which are imported), thereby promoting equity without stifling growth.

Economic theory supports VAT only if one does not care about distribution and if one can impose a tax on all commodities. You don't need an economics PhD to recognize that, in developing countries, you can't impose a tax on all commodities. Moreover, you should care about equity. So the next time you hear rumblings in the legislature of an emerging democratic country against this or that "technocratic" proposal, think twice before dismissing the deputies' doubts as populist rants. Perhaps the populists are popular because they know something that the technocrats don't.