

# MARKETS, INSTITUTIONS AND MILLENNIUM DEVELOPMENT GOALS

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*The Millennium Development Goals (MDGs) may have noble objectives but there are concerns that the associated transfer of resources from wealthy to poor countries could be counter-productive in terms of long-term economic performance. Reforming the institutions of governance and removing barriers that hinder the efficient functioning of markets are the most effective ways for poor countries to achieve MDGs. Poor countries can also improve living standards by relying on market forces rather than monopolistic public agencies for the delivery of services.*

## Introduction

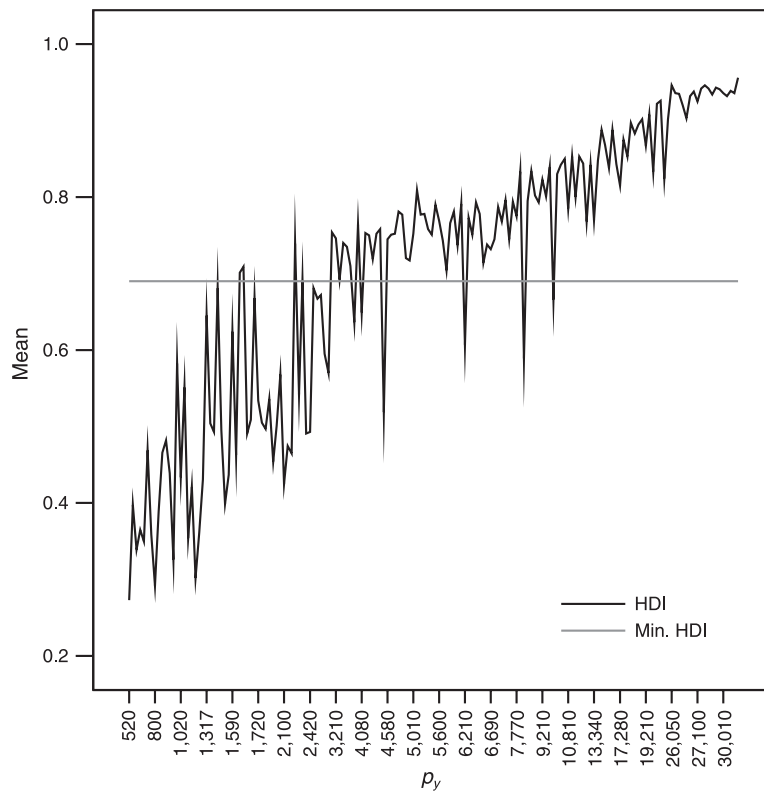
The Millennium Development Goals (MDGs) have become a primary focus of policy initiatives in developing countries since the adoption of the Millennium Declaration by the United Nations General Assembly in 2000. The MDGs include specific targets on a number of human development indicators such as halving chronic poverty, achievement of universal primary education, significant reductions in maternal and child mortality, and halting the HIV/Aids infection rates. These goals represent what the international community considers a minimally acceptable quality of life and are expected to be met by 2015. A cornerstone of the United Nations' strategy to achieve the MDGs is the transfer of resources from developed countries to developing countries. Thus, commitment by high-income countries to provide substantial amounts of resources is a necessary condition for the achievement of the MDGs.

The spirit of the MDGs is noble and commendable. The goals are consistent with long-term development in that they focus on the core elements of human capital such as education and health that have a direct impact on productivity. Nevertheless, there are concerns over the viability of the proposed strategy since to some degree it is dependent on resources from developed countries. Of particular concern is the possibility that such a strategy might not be an effective way to deal with the key factors that hinder human development. Furthermore, the approach is unlikely to be sustainable and may undermine long-term

development. This paper suggests that reforming the institutions of governance and removing barriers that hinder the efficient functioning of markets are the most promising ways for poor countries to achieve MDGs. In addition, it is suggested that poor countries can substantially improve the quality of life of their citizens by relying on market forces rather than monopolistic public agencies for the delivery of services.

## Simple economics of MDGs

The human development index (HDI) is a composite index that captures how various countries perform in terms of some key measures of human development, including literacy and life expectancy. HDI is therefore a good proximate indicator of how well nations fair in regard to the MDGs, although the goals also include broader aspects of human development. In 2002, for example, Norway had the highest HDI (equal to 0.956) while Sierra Leone had the lowest HDI (equal to 0.273) (UNDP, 2004). Using 2002 data, Kimenyi (2006, 2007) estimates that countries whose development indicators are equal or similar to levels targeted by the MDGs score an HDI of about 0.69. Thus, an HDI equal to 0.69 can be considered the lowest HDI that is consistent with MDGs. I refer to this human development index as the *MDG-equivalent HDI* (MDGEHDI). The MDG-equivalent HDI represents the lowest level of human development acceptable in terms of the targets set in the Millennium Declaration. Countries that have lower HDI can then be considered as having a *human development*



**Figure 1:** Human development index and per capita income

*deficit*. To formulate appropriate strategies to achieve the MDGs, it is necessary that we have a good understanding of the determinants of the human development deficit.

Consider Figure 1, which depicts the simple relationship between the human development index and income. The figure shows that there is a generally positive relationship between  $p_y$  and HDI.<sup>1</sup> The horizontal line represents the minimum HDI that is consistent with the achievement of MDGs. Examination of data reveals that only very few countries with a per capita income of \$2,400<sup>2</sup> or less have an HDI equal to or above 0.69. All the other countries in this income range have HDI values that are below the MDGEHDI. In fact, a number of countries with per capita income above \$2,400 score below the MDGEHDI. Thus countries with a per capita income less than \$2,400 are unlikely to achieve and sustain the desired level of human development. Taking a per capita income of \$2,400 as the minimum or threshold income necessary to achieve the target level of human development, one can then think of the human development *income deficit* as the difference between the threshold income (\$2,400) and a country's actual per capita income.

As observed above, the data reveal that there are many countries with higher than minimum threshold income and yet they have HDI levels that are lower than the MDGEHDI. In essence, these are countries that otherwise have been able to raise incomes to or above the minimum threshold necessary to achieve human development targets but are not achieving these targets. In the following

analysis, these countries are considered to be characterised by a human development '*effort deficit*'.

Merely looking at the HDI value in relation to the per capita income may not reveal the entire picture about the concept of a human development effort deficit. Even though countries may, by our definition, be categorised as having an income deficit, it is possible that they could also be characterised by a human development effort deficit. This would be the case where a country could achieve higher scores of the measures of human development even with low incomes. Thus, some poor countries could be characterised by both income deficit and effort deficit. The countries are therefore classified into categories based on income and human development effort deficits as follows:<sup>3</sup>

1. High human development, high income: countries have high incomes and also achieve or surpass the MDGEHDI.
2. High human development, low income: countries score at least the MDGEHDI, though they have incomes less than the threshold income (income deficit but high human development).
3. Low income and low human development: countries that have low incomes and also low HDI scores (income-deficit countries).
4. High income and low human development: countries that have high incomes but are characterised by low HDI scores (effort-deficit countries).

**Table 1:** Human development deficits

Low income/high human development			Moderate to high income/ high human development	
Uzbekistan			<i>Developed</i>	<i>Developing</i>
Kyrgyzstan			Norway	Armenia
Georgia			Sweden	Libya
Vietnam			United Kingdom	Azerbaijan
			Japan	Cuba
			Iceland	Algeria
			Ireland	Fiji
			United States	Costa Rica
				Albania
				Jamaica
				Sri Lanka
Low income/low human development (income deficit)			Moderate to high income/low human development (effort deficit)	
<i>Effort deficit</i>			<i>Not effort deficit</i>	
			<i>Africa</i>	<i>Other</i>
Angola	Mali	Tajikistan	South Africa	India
Burkina Faso	Burundi	Mongolia	Swaziland	Nicaragua
Guinea	Zambia	Malawi	Botswana	Honduras
Niger	Benin	Romania	Namibia	
Guinea Bissau	Ethiopia	Yemen	Gabon	
Rwanda	Chad	Moldova	Egypt	
Uganda	Gambia	Nigeria		
Togo	Senegal	Kenya		
Morocco	Eritrea	Tanzania		
Sudan	Sierra Leone			
Zimbabwe	Central African Rep.			
Mauritania	Namibia			
Mozambique	Côte d'Ivoire			
Mali				

Table 1 shows a sample of the countries categorised as above. The low income, low HDI countries are also subdivided into two categories depending on whether they are also effort deficit. As is evident, most African countries are in the income-deficit category but many are also characterised by effort deficit. That is, even with low incomes, these countries are characterised with lower HDI scores than would be expected and hence they are also effort deficit countries.

### Determinants of the human development deficit

While transferring resources can contribute towards the achievement of the MDGs, such a strategy would have to involve large amounts of resources to bridge the income deficit. Even then, such transfers might not necessarily go towards improvements in the quality of life given the marked effort deficit characteristic of these countries. Certainly, the infusion of resources from developed countries can help countries deal with some serious developmental challenges. For example, there is evidence that support by developed countries has contributed to slowing down the spread of HIV/Aids in sub-Saharan Africa. But foreign aid cannot be expected to solve the human development deficit unless the resources lower the income deficit and also the effort deficit. As a matter of fact, there is evidence that foreign aid may have a limited impact if the institutions are weak. Thus it is likely that

resources to developing countries may have a limited impact on MDGs if there are no major improvements in institutions and economic freedom. In particular, it is quite evident that such a strategy is unlikely to be sustainable unless it results in substantially higher economic growth rates than have been realised in the past (see Easterly, 2006).

A large volume of literature alludes to the importance of the quality of institutions in the attainment of overall economic development (Clague, 1997; Kaufman *et al.*, 1999; Keefer, 2004; Kimenyi, 2006; Kimenyi and Mbaku, 1999; Nkurunziza and Bates, 2003; North, 1990; Olson, 1993, 1997; Powelson, 1994). Other studies suggest that the most important determinant of a country's economic development is the degree of economic freedom (Berggren, 2003; Gwartney and Holcombe, 1999; Mbaku and Kimenyi, 1997). Accordingly, this investigation examines how the quality of governance and degree of economic freedom influence the size of the human development deficit.

A simple empirical analysis is therefore undertaken of the determinants of the human development deficit computed simply as the difference between a country's HDI and the MDGEHDI (that is HDI-0.69). Countries that have not reached the MDGEHDI have positive values of the human development deficit while those which have an HDI less than 0.69 have negative values. Larger positive (negative) values imply a larger (smaller) human development deficit. The human development deficit is regressed against a number of

Explanatory variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Constant	0.502 (9.55)***	0.176 (6.65)***	0.229 (9.82)***	0.167 (6.18)***	0.076 (3.28)***	0.378 (5.75)***
Economic freedom index	0.618 (9.45)***					0.251 (2.28)**
Democracy rank		0.554 (7.78)***				
Corruption rank			0.678 (10.39)***			0.437 (3.72)***
Press freedom				0.526 (7.23)***		
Political instability index					0.393 (4.66)***	0.151 (1.89)*
Adjusted $R^2$	0.377	0.302	0.455	0.271	0.147	0.535

**Table 2:** Determinants of human development deficit ( $n = 120$ )

Note:  $t$ -statistics in parentheses. Asterisks denote significance at 1% (\*\*\*), 5% (\*\*) and 10% (\*).

institutional characteristics that capture economic freedom (Economic Freedom Index) and quality of governance institutions (democratisation, corruption, press freedom and political stability indices). Indicators of institutional quality and economic freedom are the rank orderings, with lower ranks representing better institutional quality. The results shown in Table 2 confirm that as institutional quality and economic freedom deteriorate (higher values), the human development deficit increases. The results confirm the importance of economic freedom and quality of institutions in raising the quality of life. As far as human development is concerned, both economic freedom and governance features are complementary.<sup>4</sup>

It is well-established that economic freedom is a key determinant of economic growth. As already observed, a certain level of income is necessary to achieve MDGs. In other words, countries must focus on improving the performance of their economies for them to achieve the MDGs. This strategy is particularly crucial to African countries, most of which are characterised by a human development income deficit. In essence, a particularly viable strategy for poor countries to achieve MDGs is for them to focus on improving aspects of economic freedom.

To demonstrate the importance of economic growth in increasing the achievement of the MDGs, a simulation is conducted in order to estimate the time it would take the countries to meet the MDGs threshold income. Table 3 lists a number of African countries and their per capita incomes in year 2002.<sup>5</sup> If it is assumed that the countries must have at least \$2,400 to meet the human development goals, then the time it would take for the countries to achieve the human development threshold income can be computed. For illustration purposes, rates of growth of 1.5%, 3% and 4.5% are assumed.<sup>6</sup> What is apparent from Table 3 is that the majority of African countries are unlikely to meet the Millennium Development Goals unless they sustain higher levels of economic growth than have been the case in the recent past. Even if a high growth rate of

4.5% is assumed and that countries are not effort deficit, many of the countries would still take over two decades to meet the MDG-equivalent HDI. Nevertheless, there is really no viable shortcut to achieve and sustain high human development.<sup>7</sup> This is the reality, and the history of economic development reveals that countries that today have high human development have largely done so by maintaining consistent economic growth and wealth accumulation. The evidence provided above suggests that the key focus for African countries must be on improving the functioning of markets by reducing the cost of doing business in those countries. In short, these countries can only achieve the MDGs through high rates of economic growth which in turn require major improvements in economic freedom.

The other focus must be on improving governance. In fact, weak governance might be one reason why the countries are characterised by the human development effort deficit. For example, corruption will tend to result in the diversion of public resources to individuals instead of improving the quality of services such as education and health. Likewise, press freedom and the degree of democratisation are important in terms of monitoring the behaviour of public officials. These are important dimensions of institutions that can go a long way to improving the quality of life of the citizens through improvements in resource allocation. In addition, it is apparent that political instability in Africa has had a detrimental effect on the quality of life. Such instability inhibits economic growth through reduced investment and market exchange. Furthermore, conflict results in the allocation of resources away from delivery of services such as health and education to the military and police.

The achievement of MDGs necessarily requires the efficient delivery of key services such as education, health, sanitation and water. A large number of studies show that even with resources currently allocated for these services, many African countries operate inside the service possibilities

**Table 3:** Time necessary for countries to meet the human development deficit income (assuming no effort deficit)

Country	Per capita income 2002 (\$)	Number of years to attain \$2,400 assuming annual growth rate of 1.5%	Years to attain \$2,400 assuming annual growth rate of 3%	Years to attain \$2,400 assuming annual growth rate of 4.5%
Ghana	2,130	8.0	4.0	2.7
Angola	2,130	8.0	4.0	2.7
Djibouti	1,990	12.5	6.3	4.2
Sudan	1,820	18.5	9.3	6.2
Gambia	1,690	23.5	11.8	7.9
Senegal	1,580	28.0	14.1	9.4
Côte d'Ivoire	1,520	30.6	15.4	10.3
Togo	1,480	32.4	16.3	10.9
Uganda	1,390	36.6	18.4	12.4
Rwanda	1,270	42.7	21.5	14.4
Central African Republic	1,170	48.2	24.3	16.3
Burkina Faso	1,100	52.3	26.3	17.7
Benin	1,070	54.2	27.9	18.3
Mozambique	1,050	55.5	27.9	18.7
Kenya	1,020	57.4	28.9	19.4
Chad	1,020	57.4	28.3	19.4
Congo	980	60.1	30.3	20.3
Mali	980	60.1	30.3	20.3
Eritrea	890	66.0	33.5	22.5
Nigeria	860	68.9	34.7	23.3
Zambia	840	70.5	35.5	23.8
Niger	840	70.5	35.5	23.8
Ethiopia	780	75.0	38.0	25.5
Madagascar	740	79.0	39.8	26.7
Guinea-Bissau	710	81.0	41.2	27.6
Congo Dem. Rep.	650	87.7	44.1	29.6
Burundi	630	89.9	45.2	30.3
Malawi	580	95.3	48.0	32.2
Sierra Leone	520	102.7	51.7	34.7

frontier, meaning that a higher quantity and quality of services could be provided with the same set of resources. This is primarily because service delivery is characterised by high levels of corruption and bureaucratic laxity (Kimenyi and Meagher, 2004). To a large extent these failures are due to the weaknesses in accountability associated with public provision of services – teachers and medical personnel who do not show up for work; bureaucrats who demand bribes before services are provided; and the widespread diversion of resources for personal use. These outcomes are consistent with the empirical results presented earlier that show that governance is important in explaining the human development deficit.

There is ample evidence that shows that innovations in service delivery result in substantial gains in terms of access and quality of services. Such innovations involve introducing market forces in public service delivery such as allowing competition amongst public providers, contracting-out services to private providers or even the use of vouchers (Kimenyi and Shughart, 2006). The evidence shows that reforming the public sector and the marketisation of public services can go a long way in improving service delivery and thus these are important strategies for achieving MDGs.

One concern has to do with countries in the lower right box (high income/low human

development). According to our discussion above, these countries are characterised by low human development effort. Yet many of the countries are considered high performers in terms of governance and hence would not be expected to suffer from a human development effort deficit. It does appear that the concentration of relatively good performers from Southern Africa could be due to the high prevalence rates of HIV/Aids. More analysis is necessary to unravel the apparent low human development in this region.

## Conclusion

The MDGs represent a co-ordinated attempt by the international community to raise the quality of life in poor countries. These goals focus on key aspects of human capital that have salutary impacts on overall development and therefore deserve international focus. However, while it is true that a transfer of resources from developed countries to developing countries can indeed help the countries deal with some of the serious human development catastrophes that they face such as HIV/Aids, transfers can only go so far. In this paper we have analysed the human development deficit in terms of both income and effort deficits. It has been suggested that achieving and sustaining high rates of human development should involve changes that

result in higher rates of economic growth and specifically must involve improvements in the quality of governance and economic freedom. In addition, there is scope to increase the level of human development by improving service delivery through innovations that inject market forces in the otherwise monopolistic public provision.

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1. A positive relationship is expected first because income is one of the components of HDI and, second, all other components of HDI require investments that depend on income.
2. The income data are expressed in terms of purchasing power parity (PPP).
3. The procedure adopted involves estimating a simple regression of HDI against the log per capita income. We then look at the predicted values and residuals of the regression. Positive residuals mean that the country's HDI score is higher than predicted. In other words, the country is doing better in terms of human development than expected, given its level of income. On the other hand, negative residuals imply that the country is doing poorly in terms of human development than expected, given its level of income. That is, negative residuals imply human development deficit.
4. The institutional variables are highly correlated and thus it is not necessary to include all of them in the same regression.
5. We have selected all countries in sub-Saharan Africa whose per capita incomes were below the threshold income in 2002.
6. The idea is to compute the value of  $n$  given  $Y_n = Y_t(1 + g)^n$  where  $Y_n$  is the minimum income to meet the human development goals,  $n$  is the number of years necessary to achieve  $Y_n$ ,  $Y_t$  is the current income and  $g$  is the annual income growth rate.
7. Of course there are a number of countries that have low incomes and yet they record high levels of human development. These countries are shown on the top left-hand box of Table 1. There are only a few countries in this category and all of them benefited from massive transfers from the Soviet Union. Unless the countries adopt pro-growth policies, the countries might not be able to maintain the high levels of human development. Likewise, Cuba and a few other countries which are in the top right-hand corner box have been beneficiaries of transfers from the former Soviet Union.

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