

Outline of "Enhancing GDP Growth Through Increased Think Tank and Consulting Firm Activity"

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(A discussion draft of this note will be posted on about 5/15/03 on the web at:
<http://users.erols.com/rmyers1/TT-CFOutline1.pdf>)

I. Introduction

This note is based on the endogenous growth concept¹ that GDP growth increases as the income rewards for the introduction of technical change (i.e., innovation) increase. Similarly, GDP enhancing policy advice (PA) expands or improves as the income rewards, competition and participation in domestic think tank (TT) and consulting firm (CF) activity rise.

II. Innovation and Policy Reform Stimulate GDP Growth

This section makes three points. One is that the theories of how technology affects GDP growth are precisely applicable to how policy advice and reform affect GDP growth. The second is that based on an evolving acceptance of endogenous growth theory, it is appropriate to also view policy reform as an endogenous process. The third is that the budgets (expenditures) of think tanks and consulting firms are part of GDP so growth in TTs and CFs implies growth in GDP.

A. How Policy Advice Affects GDP Growth

This section uses a CES production function ($Y_t = A_t \cdot L_t^a K_t^b$) and some history from the World Bank to establish that technical innovation and policy reform have the same effect on GDP growth. It has traditionally been assumed that technical innovation is freely available and occurs like manna from heaven, independently of increases in (but not necessarily changes in the pattern of) income rewards.

B. Can Policy Advice be Transferred Across Counties' Public Sectors?

In general, public sector and Donor institution attempts to increase development by transferring or grafting technology to developing countries have failed. Like technical innovation, policy advice is freely available but not generally transferable across different countries' public sectors. This can be deduced from failures of nearly all Donor-initiated policy reform aid operations such as World Bank SALs. Such operations have generally caused neither policy reforms nor increases in GDP growth.

C. Policy Reform (more, better policy advice) is an Endogenous Process

This section uses an "adding up" or income distribution function [$P_y Y = w \cdot L \cdot A^L \cdot MP_L + r \cdot K \cdot A^K \cdot MP_K$, where $A^L, A^K = f(W, L, r, K)$] to make the point that technical innovation is endogenous, or sensitive to the amounts and distribution of income rewards. It then argues that the policy reform process is similarly sensitive to the amounts and patterns of income rewards. The argument is that private professionals and enterprises (TTs and CFs)

¹ See: William J. Baumol, The free-market innovation machine: analyzing the growth miracle of capitalism: Princeton University Press, 2002, 318 pp. and Acemoglu, Daron, "Technical Change, Inequality, and the Labor Market," Journal of Economic Literature, Vol. XL (March 2002).

stimulate beneficial policy reform through the pursuit of income and status rewards.

III. Think Tanks (TTs) & Consulting Firms (CFs) are Private, Policy-Providing Enterprises

This section relies heavily on my notes on Think Tanks on my web page (see: <http://users.erols.com/rmyers1/LnksThnkTnks1.htm>). TTs and CFs are private, service providing enterprises with three main functions.

A. Three Functions of TTs and CFs

1. Collect, research and prescribe social policies
2. Provide jobs and retraining for cadres of potential, higher-level public sector professionals
3. Disseminate information (e.g., to news organizations) about current social policy/program issues

B. Mode of Operation of TTs and CFs

They are service providing private enterprises. This is described in detail in this section.

C. The importance of competition and being private enterprises

Based on the TFP literature², it is clear that competition amongst fragmented policy advice service providers is the only way to ensure that policy reform advice will be of sufficient quality and appropriateness so that it will be accepted and lead to higher GDP growth.

IV. Conclusion

USAID subsidies for private TT and CF competitive activity will enhance GDP growth. The key to delivery of the subsidies is to ensure that they don't reduce competition amongst Think Tanks and Consulting Firms.

² See: Eric J. Bartelsman and Mark Doms, "Understanding Productivity: Lessons from Longitudinal Microdata." JOURNAL OF ECONOMIC LITERATURE, Vol38, (Sept. 2000, pp. 569-594) and Arnold C. Harberger, "A Vision of the Growth Process." AMERICAN ECONOMIC REVIEW; Vol. 88, No. 1: 1-30, March, 1998.