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Putting Economic Growth at the Service of Human Development

1.The Simple-minded View of How Economic Growth Raises Human Welfare.

Economics as purveyed in the simple textbook version portrays the individual as a straightforward rational consumer with fixed tastes who works mainly to earn the wherewithal to buy goods and services. Whatever other aspects make up that person are left aside in the economic analysis of how to maximize the person's welfare. His/her tastes/preferences are typically assumed to be related only to his/her welfare, not to anyone else's. Little or no allowance is thus made either for altruism or for antisocial behaviour in this world. Given this "rational moron", as Sen described the caricature, simple economic theory says much about how competition can contribute to satisfying her needs and raising her welfare, through superior allocation of resources, provision of incentives for investment and technological advance and generally keeping people on their toes and productive. Although somewhat more complicated theories admit of the advantages of monopoly power, whether to induce research and innovation (hence patents) or to provide a stronger incentive and the resources needed for such innovation (temporary monopoly, a la Schumpeter), the general tenor of the economics discipline places much emphasis on the beneficial effects of competition, even when it is "imperfect" competition, as in the case of oligopoly. Competition helps to promote economic growth; enough growth should create the "economics of paradise."

Had a Martian landed on earth one hundred years ago, taken stock of the state of the economies of Western Europe and North America, then in the midst of the growth spurt associated with the first wave of globalization, been imbued with the above economic conventional wisdom, then left and only read accounts of the economic growth of these regions over the last hundred years and finally returned now to check things out, he/she/it would probably be shocked to find significant levels of poverty and unhappiness, and a world which could not readily be mistaken for paradise. These are all very rich societies relative to what would a hundred years ago have been seen as the material accoutrements of happiness. Their economic growth has outrun the enormous increase in population over the century but they, together with humanity as a whole, appear less than fulfilled, just as they prepare to face an environmental crisis not yet on the radar screen at the beginning of the last century. Noting that the impressive amount of economic growth achieved had not eradicated poverty or produced universal happiness, the Martian would have had some questions about the adequacy of the economic thinking received a century earlier.

Had the Martian paid a quick trip around the early 1980s, as the wave of market-friendly economic reforms were beginning to be put into place, and digested the optimistic predictions emanating from the proponents of those reforms (faster economic growth for more open economies, income convergence across countries and between North and

South), he/she/it would have expected to see a large and generalized reduction in Third World poverty and in world inequality by the current return trip a quarter century later. Instead he/she/it would find a growth slowdown since the third quarter of the century and rather frequent increases in inequality in both industrial and developing countries, such that the rate of world poverty reduction had slowed.[1] The Martian would be duly impressed by the success stories in the world's two largest countries, China and India, in both of which the reduction of poverty, as usually measured, had been striking, but this satisfaction would be partially offset by the rise in the poverty incidence in Sub-Saharan Africa. And poverty measures more sensitive to people's self-assessed level of welfare would generally show much less poverty reduction in virtually all countries than the official figures.

Though world income (output) had grown by many fold and income per capita income by 4-4.5 fold over the century (based on interpolation of figures from Maddison, 2001,126) there is extreme inequality in the world income distribution, such that at the end of the century the richest ten percent of world population received about 65 times more income (defined in purchasing power terms) than the poorest ten percent (Berry and Serieux, 2004, 168) and the poorest half had a little under 10% of total income, while the top half had just over 90%. This pattern had not changed much during the second half of the century (Bourguignon and Morrisson, 2002). On the brighter side, life expectancy increased dramatically, from 31 in 1900 to 66 a hundred years later (Maddison, 2001, 30).

No earthling would of course take literally economic theory's portrayal of the human being. But many people do presume that, the oversimplifications involved notwithstanding, the picture with respect to how economic growth affects human welfare is reasonably accurate, accurate enough so that we do not need to worry too much about searching for major reforms in the growth process or in the character of our societies. The question is whether using such a simple construct to help think through economic policy leads to serious errors. This is an empirical question, but there is overwhelming reason to believe that the answer is yes. Perhaps the perspective provided by the infrequency of the Martian visits would have helped us all.

This paper addresses a set of problems that have impeded or short-circuited the expected positive effects of economic growth on human welfare. It first considers why economic growth in industrial societies has failed to improve self-declared welfare as much as simple economic theory would predict, and suggests that the factors involved are in varying degrees present in developing countries and will become more so to the extent that these countries converge culturally towards the Western mode. It then discusses reasons for the partial failure of the market-friendly reforms instituted in most developing countries since the late 1970s to produce equitable growth. The combination of a very

[1] With a poverty line of $500 1985 international dollars, Berry and Serieux (2004, 154) report that world poverty incidence fell from 25.7 in 1980 to 14.6 in 1990 and to 12.1 in 2000. The data used included estimates for all medium and large countries including 85% of world population. Reliable data were not available for a number of smaller countries. A similar pattern emerges when lower poverty lines (like the popular 1 dollar per day line) are used.

general weakness of economic growth to produce commensurate improvements in welfare in the now industrial countries, together with the more recent failure of a set of specific policies to provide the silver bullet in developing countries, and the looming environmental crisis with its indication that life styles may need to be radically redesigned, points to a serious need for attempts to achieve more basic changes in societies and the economies they spawn than have usually been countenanced. It is argued that economic growth has been very inefficient in its presumed objective of raising human welfare, for reasons that are not only identifiable but also at least partially capable of correction through wise policies.

2. Economic Growth and Welfare in the Real World

2.1 A Basic Long-Run Challenge— Addressing the Weaknesses of Modern Competitive Society

Defining human development or human welfare is not easy, and debates naturally surround that question; but whatever human welfare is, that is what we seek through economic development. Yet many people have reasonable doubts as to whether economic growth, as it is occurs on the ground, contributes nearly as greatly to human welfare as it should. What is striking is the lack of research into this question, and the extent to which a very simple measure of economic progress—growth of per capita GDP, remains the near-universal yardstick against which economic performance is measured.

Human welfare (for almost all imaginable definitions) and economic growth are related causally in both directions and in many different ways. Economists have increasingly studied the growth benefits of education, better health and, more recently, “social capital”. Ranis et al (2000) studied the implications of a country’s human development being either atypically high or atypically low (“lop-sided” in their terminology) relative to other countries with similar levels of per capita income, reaching the conclusion that higher than normal human development performance sometimes launched the country into a virtuous circle of strong performance on both counts whereas the atypically low human development cases (economic performance better than human development performance) were unable to evolve from that situation to the virtuous circle. Several additional types of analysis are needed to help societies to uncover the links between economic growth and welfare so that societies may plan their futures in a more intelligent way.

To direct their efforts most meaningfully, economic policy-makers, like everyone else, must start (in order not to be open to the charge of internal contradiction) with some concept of the good society. As a discipline, however, economics has never taken this issue seriously but rather finessed it (and thereby left the philosophizing to others) by making three simple but rather “heroic” assumptions: first, that, ceteris paribus, each person and therefore the society as a whole is better off when it has more rather than less goods and services produced; second, that the distribution of those goods and services among people does not matter; and third, that there are no interesting relationships between either the amount of those goods and services which are produced or the way they are produced and any of the other determinants of human welfare. The first assumption may be defensible but the other two are certainly not.

What goes wrong to weaken or derail the causal chain from economic growth to human happiness/welfare implicit in these assumptions? It oversimplifies in many dimensions of reality, but the key ones (interrelated, needless to say) appear to be several:

i) Income distribution matters to overall societal welfare, both because the additional benefits from one more dollar of consumption are much greater for poor than for rich people, and because the existence of inequality is itself a source of unhappiness for many people[2];
ii) People are not the benign and independent receptacles of welfare produced by goods and services portrayed in standard consumer theory;
iii) Tastes and values are not fixed but part of an endogenous system of interaction and change;
iv) Competition brings many problems and contributes to much welfare loss together with the benefits it brings;
v) Societies face major challenges in making good public choices due to imperfect information and understanding of those choices and to the damaging use of power around political and social processes.

The not very paradise-like situation of most industrial countries (some better and some worse) is the result of the ways reality has played itself out under the conditions of capitalist market economies. To go to the anti-paradise end of the spectrum, and to single out Western capitalist societies (though not to imply uniqueness in any of the characteristics mentioned) the description would be something like the following. The key elements of the brew would be widespread socially damaging competition, manipulation of tastes in a way that keeps people less happy than they might otherwise have been, and societal inability to make wise choices around major issues of collective importance (guns, drugs, treatment of felons, the environment). There is a range of outcomes across the industrial countries, but the overall picture is at best mixed.

The first practical step in thinking about this issue is to recognize that per capita income is a weak indicator of the level of human welfare. This fact emerges clearly from the "happiness surveys' that have now been undertaken in some countries for a number of decades.[3] Whatever their flaws, they are likely to be more reliable as a source of understanding the links between the economy and welfare than are the *ad hoc* presumptions of simple economics. Among many other messages we get from these surveys, two stand out: one's relative income matters a great deal to reported happiness

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[2] A low enough level of inequality such that poverty not coexist with general richness could come about in any society where wealth is reasonably well distributed, i.e. the primary distribution of income resulting from market processes would in that case be fairly egalitarian. Alternatively, if this primary distribution of income were unequal, a process of taxes and transfers or other forms of intervention in the pure market process would rectify the problem.

[3] See ??????

or satisfaction, and one's social situation (friendships, involvements) also matters a great deal. This explains why a relatively low-income country, the Philippines, can come out at the top of the happiness scale, as it has in some comparisons. Some scholars have argued that the greatest society to date was achieved by the Athenians [4] in the days of the philosophers and dramatists, based on features like the high share of the population engaged in serious intellectual life and the small attention given to the frivolities of modern Western life, like outdoing one's friends in dress. No wonder that the Romans, with their spectacles to keep the masses entertained, felt that the Greeks among them were snobbish. Those Greeks would probably have looked down their noses at reality TV as well. Many Third World leaders and thinkers have decried the apparent loss of things they valued in their society to the onslaught of modernization and growth. Julius Nyerere asked rhetorically whether and how "African Brotherhood" might be retained even as economic advance took place. Many people in Western societies also harken back to what was "better' about the earlier periods in their own countries. All such views and concerns point to the fact that we do need to take much more than GDP and its distribution into account in socio-economic planning. The happiness indices make it clear that, in most Western or Western influenced societies, the envy factor makes income inequality a direct cause of much loss of happiness.

The fact that economists, IFIs and many people in governments measure the success of public policy not exclusively by growth rates, but with some consideration also for unemployment rates and sometimes poverty rates is a step in the right direction. But it is a very limited one, partly because in the developing countries there is (with technical justification or not) less consensus on the policies needed to deal with poverty than in those needed to achieve growth. But even giving significant weight to the goal of alleviation of poverty, measured by the usual indicator of income or consumption, does not address the more general costs of jealousy and invidious comparisons throughout the social and economic hierarchy. Perhaps it has been pure good luck that economists eventually came to the conclusion that both education and health, desirable objectives in their own right, were positive contributors to economic growth as well. This relieved some of the concern that social objectives would be seen to be in competition with economic ones. But it left most of the analysis partial, with benefits to those social investments taking the form of increased productivity measured quantitatively and other benefits judged qualitatively and hence often given less weight, at least by those inclined to base their decision on numbers.

2.2 Pernicious competition. Market-oriented societies are characterized by high levels of competition at many levels, each with some negative effects on welfare together with the positive ones.[5] At the personal and family level people strive to outdo others (through conspicuous consumption or wealth, purchasable status, etc.). This competition can take the form of a "zero sum game", in the sense that for one person to feel good (from "winning") someone else must feel equally as bad. The total impact on welfare is

[4] More precisely, the non-slave Athenians.

[5] It is arguable that some forms of competition are even more damaging socially in non-market societies because they may be more surreptitious and harder to control. The focus here is on mainly market economies.

especially negative if the interaction is structured in such a way that only one person can feel good while thousands feel bad, as where the preference or value system of each person gives the message “feel bad unless you come in first.” It is as if such preference systems were designed to maximize unhappiness. Forms of competition may of course be less extreme, as where participants get some satisfaction from just competing. Competing in consumption particularly characterizes societies and groups with a modicum of social mobility, so that it is important to show one’s advance. (See the British sitcom “Keeping up Appearances”).

Competition among people for jobs has the clear potential value of improving resource allocation and hence overall production, as well as maximizing a form of personal freedom. And its psychological costs might not be too great in societies that do not view jobs in a very hierarchical way. The cost also depends on how labour markets are structured. Where many people wind up competing for and strongly preferring the same job(s) for which few are needed, the competition itself can extinguish friendships as well as contribute strongly to tension, uncertainty, and feelings of inferiority. In many countries labour markets appear increasingly competitive over time as a higher and higher share of people have university training and aspire to the sorts of jobs which were traditionally associated with that level of education. As a result, many have to take jobs that they dislike or even disapprove of (telemarketeters, environmentalists working for land developers?).When labour market forces push people into such jobs, this signal should have something like the force of open unemployment to bring the point home to decision-makers that some public policies may be needed to induce the economy to generate more of the satisfying types of jobs.

Competition among co-workers can, like competition to get jobs, contribute to an efficient allocation process. On the other side of the ledger, the potential costs are loss of the social benefits of friendship, tensions, and the inefficiencies that result from lack of team play. Within the firm it may be hard for superiors to identify the work qualities of individuals, which creates a payoff for others to misrepresent their own qualities (and those of their competitors for advancement). Uncounted sitcoms follow the workings of this Byzantine process. “Social capital”, usually defined as a group’s capacity to work well together in a way that raises a firm’s or a groups collective productivity may be thought of as the opposite of excessive inter-personal competition among co-workers. It has the added merit of contributing directly to satisfaction because many people do like to work together and to be part of a team. Studies of how and how much such social capital affects economic performance are in their infancy. Analysis of the determinants of job satisfaction and the implications for trade-offs between ways of life and income are farther along but still very partial.

Social capital, like human capital before it, came to be of interest to technical economists because it was seen to raise productivity. While not wrong per se, this focus runs the risk of becoming utilitarian and exploitive. Just as business produced the “organization man”, the human robot who would best serve the organization, it could encourage the development of the “organization group” for the same reason. Some businesses promote what an objective observer would consider excessive loyalty, displayed by hard and unquestioning work; such demands lower the level of satisfaction for workers uncomfortable with them, and may produce distorted human beings out of those who do conform.

People trying to get to or near the top in a firm engage in a special type of competition This one has the special feature that how the process works itself out, by determining who get to the top, is also likely to determine how the business as a whole functions. One would reasonably presume that intense and dishonest competition on the path to becoming CEO might produce firms like those whose scandalous behaviour has made so many headlines in recent years.

Competition among firms has both obvious benefits and obvious costs, with both depending on various characteristics of industrial structure. Among the latter is the attempt by firms with market power to squeeze out socially desirable competitors, a cost which may loom large when such power varies greatly across firms and regulations are weak. Monopoly leads systematically to consumer gouging unless adequately controlled. Oligopoly firms are among the main culprits in trying to manipulate people's tastes.[6]

Competition among nations and competing groups within nations needs little commentary. It has been one of the great scourges of humanity for many centuries and remains the source of untold suffering and death. Its continued costs reflect the weakness of both world and intra-country governance.

Some types of competition may be almost unmitigated "bads" but most bring both benefits (sometimes large ones) and costs, hence require careful thought as to how the former may be obtained without the latter. Competition of all sorts increases uncertainty for many people and groups, and happiness surveys indicate that the great majority of people dislike uncertainty. But some people thrive on a degree of uncertainty, and many benefit from the access to opportunities that are to some extent the other side of the coin from uncertainty for someone else. Economic competition may contribute seriously to unhappiness even as it encourages growth. The overall impact of the competitive (individual) spirit and style on overall economic progress is hard to judge. Since the desire to get ahead has costs (one conceals information, tries to undercut others, etc.) it is unclear how much that impulse, beyond a certain level, contributes to economic growth. Firm competition also has mixed effects. Economists need to collaborate more seriously with others who understand the costs better than we do, in the search for better combinations of competition and security, better (more benevolent) forms of competition, an better ways to control pernicious competition. While some groups in many societies are working on these challenges, the net gain over the decades appears to have been modest, if positive at all.

The Taste Problem.

[6] John Kenneth Galbraith has been one of the incisive analysts of the nature of competition and the manipulation of tastes through advertising and the failure of societies to reach reasonable solutions to their collective problems.

Certain preference or taste patterns, together with their associated value systems, can be virtually guaranteed to create dissatisfaction in a society, and are thus undesirable *per se*. There is also an important link to morality, since tastes and preferences interface with the values by which right and wrong are defined. No society condones a preference to kill other people of the same group (though all too many have condoned such a preference as long as the victims are from elsewhere) but all do inevitably condone a degree of deliberate harming of others. In any case, it is clear that levels of satisfaction in any society depend on preferences, and equally obvious that it is in a society's best interest and that of its members that the preferences in question be capable of satisfaction under the constraints defined by the economic system and the resources on which it draws, and that the satisfaction of one person does not imply significant negative spillover effects on others.

Values and tastes have historically been passed along to newly minted members of a society by the culture, by religion, and by the more specific contexts (family, neighbourhood, group) within which a person finds herself. Cultural change appears in some ways to have accelerated over the last century or so. Tastes have changed even faster with the explosion of newly available goods and services. The declining influence of religion for a variety of reasons, including multiculturalism in some Western countries, has left a void in the transmission of values to the younger generation and the increasingly secular schooling system has not tended to fill that gap. Meanwhile, advertising has moved rapidly into the breach at every opportunity to mold people's tastes into those of good buyers. Much, probably most advertising in Western industrial society is, on balance, socially counterproductive. Information and entertainment benefits appear small compared to the negative effects, which include:

i) Persuading people that they should not be happy with less than product "x" . The mechanism involves diminishing the person's ability to get utility from something which previously did give it them, hence to induce them to buy the advertised item. This is a worst possible strategy to help a society to get welfare from whatever level of purchasing power it has.

ii) Part of the process of advertising is misinformation, typically pushed as far as the law and/or the knowledge of buyers will let the advertiser get away with.

iii) Weak groups are deliberately targeted with the objective of drawing them into the fold. This includes youth vulnerable to smoking (with the role of large cigarette companies differing more in degree than in kind from the way the mafia induces people into drug use), children vulnerable for advertising on toys, junk food and other unhealthy elements of life style.

Companies in search of profits pursue every venue, trying to find the chink in the defensive armour of children, older people, less educated or savvy people, and people with their defences temporarily down. While no business would overtly defend the worst of these practices, it is often claimed that advertising is important to keep demand high so that the economy will flourish. This argument, persuasive to many, is essentially false. While there was something to be said for it during the Great Depression, it is indefensible now, especially in economies with very low savings rates and excessively high consumption like the US. If advertising of the more pernicious types were constrained, the only reasonable surmise is that overall economic performance and growth would be unaffected, whereas the composition of consumption would be better since people would be buying less items that where bad for them, items they did not really want, etc.

Western societies have achieved a sort of equilibrium between freedom of expression for the seller, which allows much inaccurate and misleading advertising (the trick being to be misleading without being totally, literally inaccurate) and the victimization of the innocent. The information society and in particular mediums like television are rife with negative externalities from this process. A given program may be designed to appeal to people who enjoy violent programs, and might be tolerable if only they saw it, but the side effects may have lasting impacts on children. Commerce is happy to cater to the lowest of tastes and leave any negative externalities for society to deal with.[7] Victims and their families and supporters do fight back. A certain degree of protection is provided by consumer advocacy groups, parents groups, pressure on companies for corporate responsibility, and so on. These usually kick in when corporate behaviour is extremely bad and only act as palliatives, unless the pressure is long maintained and the damage easily demonstrable (as with auto safety and cigarette smoking). Liberal societies are constrained by not wanting to limit freedom or control the process of taste acquisition, but then the process tends to fall partially into the hands of highly amoral people.
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Of particular concern is the mismatch between residents of developing countries who have not been raised with a sufficiently developed mistrust of advertisers. The wave of globalization has given Western products with their high-powered advertising capacity the opening to prey on vulnerable societies and modify their tastes as profits dictate.

2.4 The social choice problem: Governance, ethics and information.
Although election of governments through democratic voting practices and broad electorates has increased over the last century, it is not clear that this bodes particularly well for the defence of societies against the onslaught of alien values, competitive consumption and so on. Its impact on reducing income inequalities is clear in some countries and periods (the U.K under its socialist governments being a significant example from among the industrial countries and Sri Lanka from the developing ones) but rather surprisingly limited overall.

The challenge of good governance must confront the eternal problem of political philosophy—people who aspire to power are often the sort of people who should not have it. To finesse this inherent contradiction of democratic societies, we need strong bases of information and critical capacity within the population so that the worst of those aspirants will be weeded out and the rest will be constrained away from their worst inclinations by public reaction and by control through the ballot box. This task is rendered more difficult to the extent that significant portions of an electorate are not well

[7] The contrast between state controlled and more open information systems is intriguing. The former are justly faulted for providing inaccurate and self-serving information. But none would have occasion to promote the sort of socially predatory programs that some private stations do.

educated or able to follow many issues of public policy; too many people give little attention to issues of policy and politicians except when there is a current crisis; governments benefit from unwillingness of their people to second-guess their policies on grounds of patriotism or excessive trust; the politicians and their minions become very adept at misleading the public.

A somewhat separate challenge involves making significant changes to the way things have traditionally been done. To exemplify, we may note that high consumption expectations have been one factor contributing to the increasing frequency of two-earner families. The contention that both incomes are needed to make ends meet depends entirely on how those ends are defined. The fact that in most industrial countries a one-family can now live better than 50 years ago suggests that rising aspirations as well as a direct preference by women to join the labour force explain the trend. Some sociologists attribute the high rate of psychological problems among youth to the relative absence of parents and other adults from those young people's lives and the resulting feelings of deprivation and the reliance on other youth as (inadequate) role models. This situation provides an interesting test of governance—what can modern societies do about it? Given appropriate guidance from governments, firms can easily adjust to the modestly smaller and more flexible input from workers that a resolution of this problem would entail. But understanding of such points—in particular the small economic cost of dealing with the problem, remains weak in most societies. Most also suffer a lack of leadership from politicians and others. It is cause for concern when the more ruthless and less honest in the business world are propelled to leadership by those qualities, and then proceed to influence politicians and public policy to be like them. Both within and between societies there are too many mechanisms whereby inferior elements win out over good ones.

The rising direct influence of civil society and NGOs—a sort of people power movement, has started to have an influence both domestically and internationally. In the latter context it has helped to curtail international abuse of the sort engaged in by the colonial powers. But that effect is still small relative to that of offending governments.

3. The New Challenge for Developing Countries

The growth story of the last several decades' experience in the developing world is well known. Sub-Saharan Africa has suffered a long period of mainly stagnation of per capita incomes, often rising poverty incidence and an increase in its share of world poverty; East Asia has with few exceptions done well with China growing at spectacular rates; India has also achieved a real take-off; Latin America has never recovered to approach its growth performance of the post-war decades up until 1980 and the debt crisis.

These differences in growth rates show through clearly in differences in poverty alleviation—from the relatively rapid rate in East Asia to the limited progress in most of Latin America and the worsening in Africa. The former Soviet Bloc countries have also done badly although some are on the recovery path now. But it is also true that growth has rather systematically become less productive of poverty alleviation than was previously the case, due to a general pattern of increasing in-country inequality (Berry and Serieux, 2002). While this pattern is certainly not universal, a large number of countries have shared the experience, including several from Latin America and fast-growing China. The cases of falling inequality are relatively few. The decreased poverty-reduction resulting from growth has led to comparisons designed to identify what changed between the 1970s, when that effect was still pretty good, and the 1990s when it was not. Even as poverty reduction was slowing, it became a much-discussed goal, at least in rhetoric. Meanwhile, sexual slavery has been given stimulated by tourism and by the fall of the Soviet Union, the world's refugee population remains very large and violence and insecurity plague many countries.

Among the prominent phenomena of the last quarter century or so, and hence natural candidates when one asks what changed to make growth less poverty-reducing since the 1970s, are various aspects of the process of globalization (partly policy-based and partly exogenous to policy), the more general process of liberalization of economic policy towards a more market-friendly version, the coming of the information and communications revolution, and the collapse of the Soviet Union leaving only one world superpower and the possibly related decline in foreign aid to developing countries.

The factors that may have contributed to the improved performance of some developing countries and the worsened performance of others over the last quarter century remain controversial. What has emerged from the experience of this period is that the recipe for rapid equitable growth of the sort that would most contribute to improvements of human welfare has not been in evidence in any general way, hence the slow-down in the rate of poverty reduction. Still, much can be learned from what has happened during these years, and some implications for future policy seem reasonably clear. The most general lesson comes from the wildly inaccurate optimistic predictions for the impacts of the market-friendly economic reforms—we need to get serious in our analysis and in the resources we dedicate to improving welfare in the poorer countries. The intellectual underpinnings of those reforms were far too fragile to provide reasonable confidence in their beneficial effects.

Interesting specific lessons relate to several policy areas.

1. **International financial liberalization**. The benefits for developing countries of integration with international capital markets have been less in evidence than the costs, in the form of financial and economic crises due to rapid outflows of hot money, following earlier inflows. Such crises are the main single explanatory factor in the slow growth a number of developing countries. It is clear that developing countries are very vulnerable to cycles in the industrial world when their economies cannot be adequately buffered against such instability. The benefits of the inflow of short-term capital are in any case unclear, since the resulting exchange rate appreciation can have a damping effect on economic activity.
2. **International trade**. Trade has the potential to bring benefits through resource reallocation (what traditional trade theory is about), resource accumulation and increased productivity, and fuller resource utilization. On the trade front, there seems a good argument that the big resource-allocation benefits accrue when a country moves from low (relative to potential) levels of trade to medium or fairly high levels, but distinctly less benefits in moving from there to free or nearly free

trade. Where shifts from medium levels to high levels do bring big benefits this is more likely to be associated with higher investment or faster technological change of a labour absorbing or at worst not very labour displacing type. This latter seems the exception during the market reforms. Alternatively, big benefits can come from large increases in tradables production under the stimulus of a very competitive (or undervalued) exchange rate. Since this pattern (apparent in countries like Taiwan, Korea, and Chile earlier and China now) seems able to catapult country growth rates to very high levels (through a sort of vent for surplus process) it needs to be recognized as a separate mechanism linking export growth to economic growth, which may have little or nothing to do with trade liberalization, but will mainly be triggered by exchange rate policy. Since the benefits from this strategy cannot be accessed simultaneously by all countries, a pattern of sharing through global governance would be necessary for the world to maximize the benefits from this category of trade benefits. The IFIs have not recognized the possibility that most remaining gains from increased trade could fall in either this category or the second one.

Policy related to international trade needs to recognize that going all the way to free trade may make it difficult to pursue the sort of industrial policies so effectively deployed by some of the East Asian countries. It needs to distinguish between trade increases which are employment creating and those which are employment reducing, and to try to induce the former. And it needs to be designed in such a way as to produce increases in capital accumulation and in healthy technological change. In this latter area, more research may be needed to clarify which policy instruments can work well. And, as noted, it needs to facilitate bursts of vent-for-surplus exports. Even with all this trade cannot be the sole answer to poverty alleviation; but it can probably play a significant role in many countries as long as both the countries and the world design policies thoughtfully.

3. **Agriculture and agrarian structure** are especially important in sub-Saharan Africa where a high share of the population is engaged in that sector. The two requirements for healthy growth are (i) that public and private investment together with better technologies raise productivity significantly, and (ii) that, regardless of how property rights are structured, access to land remain relatively equitable. The first challenge can no doubt be met as long as enough effort and resources are directed that way. The second involves avoiding an evolution of agrarian structure toward the Latin American pattern, with very high levels of concentration leading to extreme income inequality and reducing the potential of economic growth to improve welfare.

4. **Education**. Hopes were high a couple of decades ago that large improvements in educational levels would contribute powerfully to growth in developing countries, and that if these improvements were focussed on primary and basic secondary education the income distribution effects would also be significantly positive. In fact, levels of education have risen substantially, but the impact, while possibly

important, has clearly fallen short of the more optimistic expectations. Those expectations were overly optimistic in part because economists have tended to overestimate benefits due to methodological flaws in their rate of return calculations. Other factors include the failure of the striking enrolment increases to be matched by corresponding attention to quality, which in many countries is or remains abysmal, and perhaps a failure to anticipate what skills would be demanded increasingly in the market. The teaching establishment in many countries suffers from perverse political influence, inertia and resistance to change (which can imply job-loss for some people). The practical challenges to rapid improvement on education appear to be severe, but they must be confronted vigorously, since good and general education matters not only to growth but also directly to human welfare.

5. **Healthy small and medium enterprise (SME**). A striking feature of the export-oriented success stories of East Asia has been the involvement of small and medium enterprise in that growth. In such cases, this sector has been a major mechanism of transmission of output growth to employment growth. More generally, the achievement of healthy growth, i.e. growth which creates large numbers of good jobs, is heavily dependent on what happens in this SME sector since in most developing countries large firms and the public sector together account for only modest shares of total employment. The recent employment creation of the larger private firms which trade internationally has tended to be small, sometimes negative, as these firms adopt modern technology in order to compete internationally. Some of the instruments comprising a good policy package in support of SMEs are relatively clear but in other areas more analysis is necessary. Most countries are far below the frontier level of policy in this area, partly due to political and administrative constraints. It is unlikely that any "silver bullet" will be found which by itself releases the potential of smaller enterprise (including microenterprise), but rather that a combination of well-implemented policies will be required. That seems to be the message from the experience of countries where the small enterprise sector has flourished.

Overall, the essential challenge for developing countries is to grow in a way that rapidly increases the number of well-paying jobs, especially jobs accessible to currently low income people. All aspects of economic policy need to be evaluated against that criterion. A number of countries have done reasonably well on the growth front but not in terms of generating "decent" jobs; this tends to be reflected in rising inequality among people or families and a rising capital share of GDP. The antidote is a well-chosen set of policies to deal with the employment challenge. The task is made especially difficult because policies falling under the responsibility of a number of ministries and agencies of government have important effects on the demand for labour and must be made consistent and coherent with each other if the most favour outcome is to ensue.

4. Responding to the Longer Run Challenge

Part of the developing world now needs to surmount the specific problems of the last quarter-century or the part of it during which they fared badly. All countries, industrial or developing, face both the general challenge of making their economic performance more "welfare-friendly" and the environmental challenge of curtailing resource utilization and decreasing environmental damage, including global warming.

In confronting these problems it is essential to go back to the basic question of "what is the good society" and the related questions of what its economic components are and how they interface with other aspects of that society. If the best attainable society is a rich one (high consumption levels) then it must be attained somehow without the heavy social and welfare costs that have accompanied richness in some of today's industrial countries, and with less damaging effects on the environment. Certainly that best attainable society does not involve people suffering malnutrition because agricultural productivity is too little relative to population. But where, between these flawed options, is it to be found? There has been only a modest attempt thus far to link the ideas of philosophers, sociologists and others to public policy, including the large economic component of that policy.

A preliminary step along the right path is to shunt aside the tyranny of GDP maximization as the criterion against which economic policies are often *de facto* evaluated. Its use leads us to plunge thoughtlessly ahead towards a world that has simply not been thought out in advance. We need to look at what the happiness indicators tell us and go beneath them. At present we make rules as if the size of the economy were an end in and of itself and then ask people to adjust to it, for labour to be more flexible, for people to be more mobile. Wealthy societies, in particular, should not have lifetime learning of new technologies forced upon them because this animal, the economy, needs it. Rather they should have the luxury of undertaking the sort of learning that gives them satisfaction, and the task of public policy should be to make those desires consistent with good economic performance. Business often speaks the language of the economy "needing" certain things, with the feeling that the adjustments will naturally need to be made by people, not the economic system.

None of the above, of course, is to say that the dethroning of economic growth means its relegation to the dustbin. It remains a central condition for welfare increase in most countries; but it should not be thought of as an end in itself. In this vein one might say, broadly, that there are three types of challenge facing developing countries to make growth work effectively for human welfare.

- i) The rate of growth must be adequate. The previous section mentioned some of the reasons that it has not been adequate over recent decades.
- ii) The pattern of growth must be such that a fair share of its benefits accrue to lower income people.
- iii) The pattern of growth must be such that its damaging effects on the environment are small.
- iv) Societies must strive for the conditions that make growth more welfare-enhancing, by discouraging unhealthy competition, encouraging good value systems, etc.

Perhaps the greatest danger in the world today is the loss of the cultural strengths of developing countries as they are bombarded with ethnocentric Western ideas of the good society, which most often come from the country with the highest murder rate, incarceration rate, drug rate, etc. Even if unlimited economic openness, adoption of Western property rights and so on were to raise developing country productivity by a few percentage points—and it is hard to imagine how it could do more than that, this is a very light price to pay for retaining the satisfaction of better ways of living, of African brotherhood" as Nyerere phrased it, and so on.

Key Myths and Ironies

In searching for the ways to make growth more welfare-enhancing it is important to put to rest some of the questionable arguments whose import is to limit that potential. Certain exponents of capitalism have generated a variety of myths to justify some of its practices and some ongoing trends. Although often couched in the language of economics, these do not flow from economic theory or analysis; in fact economics provides the antidote to these views.

The myths include the following ideas:

i) Advertising, even when somewhat misleading and when designed to make people buy out of jealousy, is justified by the fact that it is important to keep demand high to maintain full employment and avoid poverty. This is virtually never true in today's societies. Even in the Great Depression, when it had more obvious merit, there were better ways to keep aggregate demand up;

ii) The economic cost of good environmental policy is very high. It appears high in part because we do our national accounts wrong, failing to include things like clean air as a benefit and things like deforestation as a cost.[8]

iii) Competition among firms and among people, and the associated degree of inequality, are necessary to achieve rapid technological change. This relationship is not well understood but it seems implausible to believe that the best types of technological change (e.g. in health care) require competition, patents and the other tools designed to link innovation with profits. It is arguable that those whose main motivation to "succeed" is to be rich do not make the more significant contributions to society; instead they develop junk bonds, devise ways to fudge their companies accounting systems and so on.. Innovators in many societies do not work primarily for the money but for professional status (which they may prefer to be rewarded monetarily but that may be because that is how our society operates).

[8] It is admittedly the case that no one knows with certainty what will be entailed to slow global warming for example. But given predictable ingenuity on the technological front and less socially wasteful consumption, it is quite reasonable to assume that there will be net benefits from the effort, independent of the fact that it may save the world as a habitable place for humanity. In the past the search for new technologies, spurred by problems (usually scarcity) with the old ones, has often been what triggered new bursts of economic growth.

iv) All other objectives must bow before the essential need of international competitiveness. The theory of comparative advantage, perhaps the single most important concept of international trade theory, implies that a country can always export, no matter how low its productivity. This theory is still in force even if, like all theories, it has to be qualified and complemented now and then. But making jobs more flexible or lowering wages (bowing to the world competition among workers) is not necessary for international competitiveness. These steps may be desirable for purposes of economic efficiency or income distribution, but should, for the most part, only be pursued for such reasons. The greatest irony is that societies whose high productivity allows them, if they desire, to have job stability and good social safety nets should, partly under the mantra of needing to compete with other countries, downgrade these objectives. Societies have to guard against waiving their well-earned right to security, relaxation, etc.[9]

v) Economic dominance of large firms is important to world economic welfare and to that of nearly all its countries. Even in narrow economic terms the benefits of economies of scale appear to be modest and limited to a few industries. The involvement of multinational firms in developing countries brings considerable damage (labour displacement, for example) together with its benefits. Schumacher's (1984) view that smallness has much to be said for it remains a useful insight.

5. Elements of a Positive Strategy

1. Education and Values

Education is a key element of human progress, even if it's contribution to economic growth is somewhat less that it was once believed to be. It can be a vehicle for the teaching of moral standards and ways of being and enjoying. While some industrial societies broadly teach the competitive way, other societies teach something closer to the cooperative way. Progress is being made in teaching new generations something about the environmental challenge, though the message remains fuzzy for many. In most countries major improvements are needed both to raise the economic and the more general social and cultural benefits to education. The overlap between societal needs to curtail competitive consumption and to limit those forms of production and consumption that damage the environment offers an opportunity to link the attacks on two very perverse patterns. For both objectives, consumption patterns need to be modified.

2. Policies to keep labour demand high

Though technological change is an essential vehicle towards increasing productivity and the process is subject to little societal control and, in its objective of raising profits, it tends to be biased towards saving labour prematurely. Society can also develop incentive system in which job creation receives a premium (Edwards, 19??). The premium can be

[9] It is of course required that societies which want to consume more must find the ways to produce more. But it is important that wise decisions be made with respect to how the collectively higher output should be used.

manipulated so that it is larger for groups where workers might not otherwise have enough options. Such systems can still leave firms with an incentive to hire good workers and avoid bad ones, but can diminish the risk that someone with limited skills will be a major victim. And it creates an atmosphere in which firms desire to hire workers is heightened, which is socially positive. Such a system can be tied to the tax system. The more workers a firm has (relative to something, either output or capital) the more subsidies it gets or the less taxes it pays. This system has not only the merits of directly improving worker welfare, but is also likely to lower unemployment and save the government through that and other channels.

3. Curtailing "bad" competition

Strategies to combat the effects of pernicious competition should come from various directions. Personal competition (desire to outdo others) must be approached in part from the angle of ethics and values. Progressive consumption taxes can be used to discourage status-related consumption and, simultaneously, to raise money for socially desirable uses. Emphasizing doing well to benefit society (though not the state), weighing oneself against one's own objectives, and having many and varied sources of satisfaction or self-fulfilment are one component. The "small" society of Schumacher has many attractive features in this context.

4. Limiting wasteful consumption and pernicious advertising

Where it is not possible to do much to control advertising and its perverse impacts, education to prepare people against it is the presumed option. Schools should have courses not only in ethics but also in personal and group survival in a world full of misinformation. Most people, students included, are not given much understanding of how to detect fraudulence. Some foreign aid could be productivity used to offset the effects of advertising. And just as rich countries should put clamps on the corrupt practices of their multinationals, they should also put pressure on the clearly immoral practices of those firms (like cigarette advertising).

5. Finding the integration between the economic and the social benefits from "social capital"

The increasing recognition that social relationships can have a positive impact on economic productivity (leading to the term "social capital") offers a certain potential for combining economic good with social good. As with human capital, the economists are likely to look mainly at the impact on productivity as traditionally defined in economics, and arguments will come forth to encourage aspects of the social capital package that can be shown to have positive productivity impacts. Thee aspects may or may not overlap closely with those which have an independent positive impact on welfare. It seems likely that a number will. The capacity of people to work well together is likely to be correlated with friendship and direct satisfaction from work as well, as contributing to productivity. It is likely to be the antithesis of perverse intrafirm competition among workers trying to get ahead at the expense of others. Honesty and transparency across workers are likely to be beneficial on both counts as well. The policy implications may not be clear, since firms may be expected to pick up on those aspects of social organization and relationships within the firm that make it more profitable. But it is possible that perverse forms of social capital will also be popular with firms, e.g. creation of obsessive dedication to work, including similarity of attitude across people; this is demeaning to the individual as a whole. So society has to address the issue and search for policy tools as well.

6. Protecting the small against the large

An economy which places some limits on large sized establishments is likely to be overall more socially productive, partly for the reasons emphasized by Schumacher and partly because, with only a few exceptions, the gains from economies of scale tend to be quantitatively modest. [10] The anti-trust instruments used with only very modest success are one approach. Progressive corporate taxes are another.

7. Drawing on civil society

NGOs may become a powerful influence to counteract bad patterns and government's support for or indifference to them. Governments are constrained by the pressure of vested interests. Just as they have been very important in pressuring for better environmental policy, so they may be in the areas of information accuracy, defence of the small, etc. Possibly monitor agencies which have had clear impacts, like Amnesty International, Transparency International and the UNDP with its Human Development

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[10] Many economic studies appear to overstate those benefits by using engineering data which miss other aspects of economic organization and, probably more important, from failure to distinguish real economies of scale from those which results from market power (ability to charge monopoly prices, pay monopsony prices, etc.) finally it is clear that technology would have less of a bias in favour of large size if it were not designed in part to give and maintain monopoly power. When all these considerations are taken into account, it seems unlikely that any country's GDP would fall very much if the presence of large firms were very considerably curtailed.