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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 cted tp(rrent reth slhe ip a)Tjreasesqual the cu 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 or satisfaction, and one’s social situation (fri 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 (telemarketers, 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 unquestioning work; such demands lower the level of satisfaction for workers

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 -15.78peiae m6pdstappch include:

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 cr

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 methodologi

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

iv) All other objectives must bow before

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 wh0h, must.0h,tust.0h,n Tw