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Presidential Address

The "Orderliness" of Economic Development

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The process of economic development–in the sense of a sustained increase in per capita income–is typically associated with dramatic changes in some key economic variables relating to the sectoral composition of production, trade, and factor-use. And this seems to suggest that it is essentially a "disorderly" affair. Some of these changes have been observed regularly enough to qualify as the stylised facts, or the "regularities", of economic development. These general observations about the real world seem to support a spate of "disorderly" hypotheses about the nature of economic development. The critical minimum-effort hypothesis, the poles-of-development conjecture, the unbalanced-growth strategy of development, the propositions advocating a big-push, the great spurt, or the process of cumulative causation, all suggest that the development process may have been disequilibrating in the "structural sense". Yet another dimension of such "disorderly" hypotheses is the pioneer's vision of the effects of growth on income distribution. Thus Lewis's "capital fundamentalism" envisages a particularly "bloody" scenario: capital accumulation proceeds relentlessly in his dual-economy model, where profits rise while real wages remain constant because the supply of labour–the Marxian "reserve army"–is (definitionally) elastic. In Lewis's model, if not in the real world, the story of (capitalist) growth comes to an end once the real wage starts to rise; this must happen because, again by definition, the wage-earners consume all that they earn. Kuznet's and also Myrdal's inverted U-shaped pattern of inequality–partially confirmed by cross-country investigations of the size distribution of income–postulates a worsening of income distribution, at least in the initial stages of economic development.

This shows that high rates of economic growth are structurally disruptive, and this is universally true; but that they are also distributionally de-equalising is something that may *not* be universally true. Such fatalistic scenarios in which the gap

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between the rich and the poor widens, unemployment increases, the share of wage-income in the GDP declines, and the incidence of poverty increases can be changed by suitable public policy. Indeed, if this were not true, and if high rates of economic growth and the associated changes in the economic structure were, as a rule, immiserising, then either we would have to accept its adverse economic, social, and moral consequences and live in sin, so to speak; or concede defeat in the war on underdevelopment and poverty and quit the pursuit of economic prosperity! Fortunately, the growth experience of many developing countries (especially that of Asian countries) does not support the existence of such a "development dilemma".

But to put the concept of "orderly" transformation, it may be noted that the many "disorderly" scenarios noted above do convey a clear, underlying equilibrating message with respect to the sectoral shifts that structural transformation inevitably entails: different sectors and classes in an underdeveloped economy entrapped in a low-income-equilibrium "vicious circle" are "shocked"–say, by tying (entrepreneurial) expectations around a high rate of investment–only to be re-aligned at a higher-income equilibrium. With respect to the distributional consequences of the growth of per capita income, the income distribution worsens in Lewis's two-sector model, in which the rate of capital accumulation is powered by an unchanged wage rate in the agricultural sector. But, as in the Fei-Ranis rendering of a dual economy, no one income group loses out *absolutely*; because once all surplus labour has migrated and the urban wage starts to rise, the wage-earners will find their lots improved. Indeed, one can think of mechanisms whereby a higher rate of growth would eventually improve the distribution of income.

These remarks seem to suggest a more optimistic outcome of the process of economic development; and, fortunately, it seems to be corroborated by the actual growth experience of the developing countries. It is to this matter that we now turn.

Development economics has now been in existence for the last 40 years and many predictions of the "pioneers", based essentially on the European experience, have been corroborated, while others remain tentative or speculative. Thus, while the structural side of the story was competently related, the questions concerning distributive justice were addressed, with the outstanding exception of Tinbergen, in a somewhat cavalier fashion. Most of the hypotheses about what would become of the distribution of income as economic development occurred rested on an "extremist" classical savings function–which *assumed* that all savings were done by the capitalists. And some important aspects of economic development were not adequately discussed by them. For instance, the issues related to the question of macroeconomic stability–i.e., the fiscal deficits, the rate of inflation, the depreciation of the exchange rate, and capital inflows–were not given the importance that they deserved in understanding the process of economic development. The relevant (cross-country) evidence, therefore, needs to be re-examined.

A sample of 40 developing countries belonging to Asia, Africa, and Latin America was chosen to re-examine the key stylised facts of economic development. It confirms some of the stylised facts observed by the pioneers. As predicted, the rate of capital accumulation has risen sharply in all developing countries, and in the fast-growing developing countries the investment rates are more than twice as high as the rate that Lewis prescribed. Indeed, by Lewis's standard, most developing countries have already solved their "central problem in the theory of economic development". Structural transformation has taken place with varying degrees of intensity in developing countries, depending on the *rate* of growth of the per capita GNP attained by different developing countries. Real success in this respect, however, has been achieved only by the high-growth countries, where the share of manufacturing has risen to above 30 percent. But the most important stylised fact highlighted by this information but not sufficiently emphasised in the literature on development economics is that a high rate of growth, macroeconomic stability, and distributive justice have generally moved together–signifying an orderly transformation of low-income countries into middle-income (and even high-income) economies. Indeed, a stronger statement is possible: *the developing countries suffering from low-growth of per capita income are generally worse off with respect to macroeconomic stability and distributive justice than those enjoying medium-growth and high-growth.* Thus, the average rate of inflation falls steadily as one moves from the low-growth countries to the medium-growth and the high-growth countries, suggesting that a high rate of growth itself has a depressing effect on inflation. And due to a lower rate of inflation and a comfortable level of exchange reserves, the incidence of currency depreciation *vis-à-vis* the US Dollar is the least in the high-growth countries as compared to the medium-growth countries and the low-growth countries. (China is an exception to this rule mostly because of the currency and exchange reforms introduced there in the last few years.) Yet another interesting observation in this context–indicating a greater degree of self-reliance by the high-growth countries as compared to the low-growth ones–is that net disbursement of official assistance and of the average net foreign (private) direct investment have moved in opposite directions: while the former tends to decline as higher rates of growth are attained by developing countries, the latter increases steadily. The only exception to this rule is South Korea, where foreign private direct investment has declined while high growth rates have been achieved–perhaps because in this group of countries only South Korea is now a capital-exporting country.

The information gathered from our sample also does *not* unambiguously support the predictions made by the pioneers–e.g., by Lewis–regarding a worsening of the functional distribution of income between labour and capital as an inevitable consequence of high rates of economic growth. Although comparable data about wages and rent are not available, yet the "facts" about some closely-related variables

appear to point in the opposite direction: they show that, in general, the rate of earnings per employee has risen over time, with the exception of those countries where the growth rate has been less than 1.5 percent. The same general conclusion emerges when the record of the high-growth countries is compared with the experience of the medium-growth and the low-growth countries with respect to such indices of distributive justice and quality of life as the rate of (open) unemployment, the adult literacy rate, the level of educational attainment, the annual growth rate of the earnings of employees, the percentage of the population with access to health facilities, the percentage of the population below the poverty-line, and the share of the lowest twenty percent in total income. Interestingly enough, the infant mortality rates declined much more during 1965–1990 in the high-growth countries like Malaysia and South Korea than in the slow-growers like Sri Lanka; and the literacy rate has increased much more in the former group of countries than in the latter. Also, the percentage of population below the poverty-line is much less in all the high-growth countries than in Sri Lanka. And, of course, unemployment is much higher in Sri Lanka than in any category of country in the sample–which, incidentally, undoes a good part of Sri Lankan gains in terms of "human development".

The analysis presented above suggests three general conclusions:

First, growing at a moderate rate, the task of economic development is well-nigh hopeless; so that the leisurely-growing developing countries will continue to 'enjoy' a comparative (or even absolute) advantage in poverty and social degradation. A little computation should make this point clear. Suppose the long-run objective for a low-income country like Pakistan with a per capita income of US$ 400 is to achieve a per capita income of US$ 21050 which is the defining level of a high-income country according to the *World Development Report, 1993*. If the growth rate of per capita income is 2.1 percent (average growth for 1980–1991) for developing countries, the target income will be achieved in 191 years. This is the Keynesian long-run in which we will certainly be dead! But if the first doubling of per capita income takes place in 12 years, it will then take 69 years to do the same with a growth rate of 5.9 percent; and that is a more reasonable waiting-period.

It should, therefore, be easy to persuade oneself that doubling per capita income in the shortest possible period of time (say in 10 to 12 years) is the "critical minimum effort" that a low-income country (with a per capita income of US$ 400) must make to achieve what Rostow referred to as "self-sustaining growth". The experience of the star-performers among the developing countries–e.g., the East Asian countries, and now China–in the last four decades shows that this is not an unreasonable growth target to aim at. The presumption is that growing at high rates also helps income distribution as the demand for labour in the key sectors of the economy increases strongly, and this then creates labour shortages–first around the growth poles and then throughout the economy. Consequently, unemployment

decreases and the level of real wages rises steadily. When this happens on an economy-wide basis, the level of "exchange entitlements" of the (unskilled) labour improves, thereby reducing the incidence of poverty among the poor people. At a deeper motivational level, when people perceive that they can cross the class (income) barrier several times in their own lifetimes, the supply of work-effort increases and leisure is at a discount. As income increases beyond a certain minimum level, an effort is made to improve the quality of life by a better allocation of time between work and leisure.

These observations also suggest that a high rate of growth of per capita income is not necessarily a sin against "human development". Irrespective of the level of their respective GNPs–for instance, China's per capita GNP is US$ 350 while that of South Korea is US$ 4,400–the high-growth countries have generally done better than the medium-growth and the low-growth countries in improving the quality of life of their people. In this connection a comparison of the growth experiences of Malaysia and Sri Lanka may be made. It is an apt comparison because the per capita incomes of these two countries were equal in 1960. Since then Malaysia has grown at a rate of 7.0 percent, and Sri Lanka at about 4.0 percent; but Malaysia has achieved greater success even in terms of human development. This comparison should also somewhat qualify Sen's recommendation that reducing poverty by "direct" means–reducing mortality, increasing literacy–is somehow superior to doing so within the context of a strongly rising per capita income; which is not to say that direct income transfers should not, *as a rule*, supplement the trickle-down effects of growth. This observation also applies to IFAD's "new development paradigm", which focuses on rural poverty *directly* based on the finding that "There is no association between the annual rate of growth of GNP per capita and changes in the income share of the lowest 20 percent or in the percentage of poor people among the rural population." But, as the preceding discussion shows, there is indeed a highly significant negative relationship between the growth rate of the GDP and poverty (including rural poverty). Similarly, the finding by Anand and Ravallion, that the association between life expectancy and the *level* of per capita income is tenuous, is not necessarily a refutation of the primacy of the growth *rate* of per capita income in the process of economic development. The point is that there is no sure route to achieve the agreed "ends" of development (i.e., human development), which may bypass the basic income-generating economic mechanism.

Secondly, the process of an "orderly transformation", as an irreducible minimum, consists of economic growth, macroeconomic stability, and distributive justice. It is not a question of achieving one at the expense of the other, but rather one of balancing at the margin the cost and the benefits of the pursuit of each of these elements of a complete strategy of economic progress. In this framework of thought, there is no place for a *systematic* tendency to "immiserising growth", in the

broader sense of (a fast) economic growth leading to a deterioration in some leading indicators of economic development–as when a high rate of economic growth is associated with a decline in the absolute income of the poorest in the society, or, as in extreme cases, with the failure of the exchange entitlement of the poor. This does not mean that such things cannot happen; it rather suggests that if they do, then economic development, as distinguished from just economic growth, lacks the comprehensiveness that *must* exist in the former process; and that such deviant behaviour should be cured by engineering a more efficient (*and* just) alignment of the forces of production.

Thirdly, like all else in the economic universe, economic development must be *managed* to be orderly; which implies that the task of management cannot be entrusted entirely to the magic of the market in the hope of achieving a Pareto-optimal allocation of resources. Kuznets notes: "Policy action and institutional changes are required [to minimise] the costs of, and resistance to, the structural shifts implicit in, and required for, a high rate of growth". The state will also have to intervene to regulate the economic tides, even if mostly to strengthen the market forces; particularly in cases where due to the severity of asymmetric information or because of the missing markets the relevant price does not exist; or because the "free riders" cannot be excluded from the consumption of public goods for which they do not pay a price; or when the "agent" commits "fraud" against the "principal"; or when the creation of "future-oriented institutions" becomes a central issue to facilitate economic development; and so on. But there are problems where just strengthening the Smithian Invisible Hand will not help. Here we face such vital issues as an adverse allocation of private property rights, the women's low status in the economic (and social) sphere, the abominable practices of child-labour and bonded-labour, the question of building up human capital (education and health), the phenomenon of environmental degradation, and the cases of acute poverty among the disabled, the old and the sick, not to underrate the population problem. In all such cases, if left to the market, the situation may grow worse rather than improve. Thus, notwithstanding the Coase Theorem, as economic growth gets going, the structure of property rights in land may worsen instead of improving so that the rural poor may get only a fraction of what they *should* get. Similarly, as the average level of economic prosperity rises, the numbers among cheap labour and bonded-labour might multiply, women's exploitation might become graver, the environment might be degraded even further, the fertility levels might not fall (at least not dramatically); and so on. In all such cases, legislative action will have to be taken to regulate the private property rights in land, to universalise the health-cover and literacy, to abolish child-labour and bonded-labour, to strengthen the position of women in the society, and to provide cleaner air and water (possibly along with a cleaner GDP) for all.

It follows that the *modern* agnosticism about the state not doing *any* good to

the society–so that the less we have of it the better–is essentially wrong-headed because there is a large area of social life where state intervention is obligatory; it is also dangerous, because a state not doing development work is not necessarily the one that would help economic progress. True, the traditional sentimental view of the state as *always* acting as a conscience of the society will also have to be modified to recognise that the state, to some extent, reflects the interests of various lobbies and pressure groups. Yet, as shown by Greenwald and Stiglitz, the fact remains that the assertion that the government can do no better than the market is simply false because efficient market allocation cannot be attained without government intervention.

REFERENCE

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