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GLOBALIZATION, LIBERALIZATION AND SUSTAINABLE HUMAN DEVELOPMENT: ANALYTICAL PERSPECTIVES

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Table of Contents

ABSTRACT

Sustainable human development (SHD) is the core objective of the process of economic growth and development. But it is also a powerful instrument for promoting economic growth, especially when investments in human development are made in the context of a liberal and open economic environment. The paper discusses the interrelationship between three complementary policy spheres: integration into the global economy and the liberalization of markets; the promotion of fast economic growth; and sustainable human development. The impact of each of these interlocking policy spheres on promoting development is considered, and a range of policy proposals is made in light of this analysis. The negative consequences of globalization and liberalization are also noted, and strategies to mitigate those impacts are located in social and economic policy. Evidence supporting the concept of *virtuous spirals*, in which a series of positive policy interventions in one sphere contribute to progress in another, is outlined and then contrasted with the inverse phenomenon, *vicious spirals*. The complexity of the overall policy environment confronting policymakers is also considered, and several weaknesses of so-called 'holistic' or 'comprehensive' development approaches are identified.

INTRODUCTION

1. In the closing years of the twentieth century, most developing countries adopted increasingly liberal strategies of economic development. They opened domestic markets to international trade, gave market forces greater play in the allocation of resources, and privatized many state-owned enterprises. There was also a sea change in policies towards foreign direct investment (FDI), with liberalizing measures far exceeding restrictive ones throughout the 1990s.[1] However, liberalization has not delivered the expected rates of economic growth and the gap between rich and poor countries has continued to grow.[2]

2. The breakdown of the World Trade Organization (WTO) meeting in Seattle has crystallized concerns about the direction of globalization, among both proponents and opponents. Strongly liberal voices such as *The Economist* described the breakdown as "a global disaster" and claimed, "the poor will be the real losers".[3] Others welcomed what they saw as the humbling of the WTO, arguing that "globalization is hurting too many and helping too few", and that "the forces behind global economic change – which exalt deregulation, cater to corporations, undermine social structures, and ignore popular concerns – cannot be sustained."[4] Meanwhile Claude Smadja, Managing Director of the World Economic Forum, has warned of the danger of a backlash against globalization, which "may put at risk the benefits that globalization has brought to both the developed world and the emerging-market economies".[5]

3. Surprisingly, there is some agreement amongst these very different commentators about the direction that should now be taken. Jay Mazur argues against building "walls against the world economy", but calls instead for "an effort to build rules into it, and a floor under it." *The Economist* admits that neither trade nor globalization in general will be sufficient to give the photogenic Indian girl pictured on its cover a better life, and that "above all she needs education, health, and much else." Claude Smadja heralds the death of the "triumphalist thesis of globalization", where globalization is conceived purely in economic terms and dictated by the "pace, modalities, and agenda" of the industrialized countries.

[1] UNCTAD, *World Investment Report*, annual.
[2] Between 1985 and 1997, more than half of poor countries fell further behind the world leader (the United States), while fewer than a quarter made significant gains. World Bank, *World Development Indicators, 1999,* Washington, D.C. The output gap is measured in terms of the ratio of a country's per capita GDP, measured in units of equivalent purchasing power (PPP), to that of the United States. Data are available for 100 countries, of whom 54 saw an increasing gap, 22 a decreasing one.
[3] See various articles in *The Economist*, 11 December 1999.
[4] "Labor's new internationalism", Jay Mazur, *Foreign Affairs*, January/February 2000. Jay Mazur is Chair of the American Foundation of Labor and Congress of Industrial Organizations (AFL-CIO) International Affairs Committee, as well as President of the Union of Needletrade, Industrial, and Textile Employees.
[5] "Time To Learn From Seattle", Claude Smadja, *Newsweek International*, January 17, 2000.

4. From a developing country perspective, it is now clear that a "*passive* policy" of liberalization is no longer sufficient and that a range of "*active* policies" is needed.[6] From an economic perspective, these policies recognize that liberalization offers economies *opportunities*. These opportunities will only be successfully exploited if sufficient capacity is developed to enable a range of actors to engage successfully with the new market conditions. Furthermore, a broader perspective reminds us that economic growth is only a means to the more significant goal of human and social development. Human capital, social capital and economic growth are all intricately bound in a series of complex relationships. Each has the potential to support the other, but equally deficits in one area can lead to deterioration in the others. Virtuous and vicious spirals are therefore possible, indicating the necessity for a balanced approach to development, although there is some evidence that a policy environment that emphasizes human development is more likely to lead to a *virtuous spiral* than one that stresses economic growth.

5. This paper discusses three complementary policy spheres, covering:

- Integration into the global economy and liberalization of markets
- The promotion of fast economic growth
- Sustainable human development

6. The three policy spheres can be characterized as intersecting circles (see figure 1). Confining policy initiatives to a single sphere tends to deliver disappointing results and it is at the intersection between the spheres that sustained development (economic, human, and social) is most likely. Democratic governments must therefore develop a balanced policy portfolio, one commanding electoral support and likely to contribute to the development of virtuous spirals of development. They must be aware of the extent of their power to promote change in any area, and of the possibility that government intervention may inhibit action by other actors. In many cases, civil society or business may be able to play a significant and increasing role in promoting broad-based development.

7. For aid organizations (operating at national or international levels) and other multi-lateral actors, there is a strong case for a more broad-based approach to providing development assistance. The World Bank, for example, is promoting a comprehensive development framework, which aims to promote partnership between different institutions and maintain progress along a number of fronts. There are still unanswered questions about whether this approach will increase the effectiveness of development assistance and how to reconcile the agendas of different national and multinational actors. Nevertheless, there is now a growing body of evidence and analysis available to policymakers seeking to develop a context in which liberalization and globalization deliver people enhanced benefits while simultaneously ameliorating some of the harsher impacts of these processes.

[6] Manuel R. Agosin, *Trade and Finance: A SHD Centred Conceptual and Operational Framework*, March 1999, unpublished.

SPHERE 1:

Integration into The Global Economy And Liberalization Of Markets

8. For most developing countries, openness to the international economy provides the best environment for stimulating growth. Many developing countries are small, and inward-looking economic strategies can therefore quickly come up against demand constraints. Countries that export are able to grow much faster, especially if they can diversify the products they bring to international markets. Openness, of course, is a two-way process. Export earnings allow increased investment and the import of modern technologies to improve productivity. At a time when markets are developing so fast, closed economies are becoming ever less viable.

9. To achieve openness, developing countries have adopted a number of policies:

- *Trade liberalization* – most developing countries have significantly lowered their trade barriers, with average tariff levels down, and tariff dispersion narrowed considerably. Countries joining the World Trade Organization (WTO), in line with their new international obligations, have dismantled a variety of subsidies and non-tariff barriers to trade. Many countries have also signed free trade agreements with neighbors, regional trade blocs, and occasionally with developed countries.
- *Liberalization of FDI* – most developing countries have liberalized their FDI regimes. Indeed, some now have FDI regimes that are distinctly more liberal than those in the developed world.[7]
- *Freeing of non-FDI capital flows* – many developing countries now look to international financial markets to supplement investment from domestic savings, and the flow of capital to the developing world has increased, though with uneven results.
- *Macroeconomic adjustment* – inflationary conditions discourage investment, weaken the ability of relative prices to act as a guide to resource allocation, and act as serious discouragement to the private sector. Recently, inflation rates have come down almost everywhere in the developing world[8], and many countries have made significant progress in balancing their budgets.

10. Achieving these reforms has not been easy, and there is now a vast literature analyzing the obstacles societies face in adopting policies that encourage openness. Much less attention has been paid, however, to the fact that even as openness is achieved, many developing countries are still failing to generate strong economic growth. There is, of course, no single explanation for these failures. The international economy is fast moving and demanding. Thus it is not sufficient for countries to simply dismantle inefficient industries in order to reallocate resources to traditional exports, themselves often of declining value. Countries must engage in a continual search for

[7] M. R. Agosin, "Liberalization and the International Allocation of Foreign Direct Investment", October 1999, unpublished.
[8] United Nations, *World Economic and Social Survey 1999,* New York.

new competitive advantage, and strive to develop capacity in high-productivity sectors. Coherent price signals are therefore needed to steer resources toward promising new export sectors. Exchange rate policies are extremely important in this respect. Often, trade liberalization is accompanied by capital inflows that appreciate the exchange rate. This ends up stimulating the production of non-tradables rather than encouraging nascent exports.

11. The experience of the successful Asian countries is instructive. For over two decades, while their exports grew at unprecedented rates, the Republic of Korea and Taiwan (Province of China) were able to stabilize their real exchange rates through active management of the market. This clearly contributed to their export performance. On the other hand, experience shows that countries using the exchange rate as an anchor for domestic prices have found that real exchange rate appreciation is very difficult to avoid, with adverse effects on the growth of new exports.

12. However, even when price signals are strong, supply responses to price signals are weak in many developing countries. Markets are often segmented regionally and labor may be geographically immobile as well as uninformed about risks and opportunities. Small producers are unable to seize new opportunities due to poor levels of education or health, a lack of organizational or technological capabilities, or inadequate access to financial markets. Poor quality management, meanwhile, can leave larger enterprises unable to respond rapidly to changing market conditions. Meanwhile, with FDI, investors look for resources relevant to their needs before committing to a country. With the emergence of increasing numbers of high-value industries, human assets have become a crucial axis for investment decisions. Thus the capacity, flexibility, and initiative of the labor market have come to lie at the heart of many, if not most, investment decisions.

13. Finally, increased capital flows can pose serious threats to the stability of a country's economy. While direct investors are likely to have at least a medium-term stake in a country's future, portfolio investors and foreign creditors have tended to exhibit herd-like behavior. Waves of enthusiasm in "emerging markets" have given way to waves of panic.[9] The result has been extraordinary booms, followed by deep recessions. These have had demonstrable effects on human and social development. The East Asian financial crisis has not only had economic effects, such as bankruptcies, increased poverty, and rising unemployment, it has also led to reduced schooling, diminished public services, and increased social stress and fragmentation.[10] As the United Nations Development Programme (UNDP) comments, economies are now recovering but "human recovery will take longer." Meanwhile, there is little evidence that countries have increased their ability to manage foreign capital flows, or have reached consensus on a new system of international financial regulation.

[9] S. Radelet and J. D. Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects", *Brookings Papers on Economic Activity*, 1998, No. 1.
[10] *Human Development Report*, UNDP, Oxford University Press, 1999.

SPHERE 2:

The Promotion Of Fast Economic Growth

14. Liberalization offers great economic development opportunities to a country, but active policies are needed to ensure those opportunities are taken up. Coherence in policymaking is also needed if fast and sustained economic growth are to be promoted. By establishing growth-friendly policies, policymakers not only increase international confidence in their development prospects, they also enhance domestic confidence that the future can offer rising levels of prosperity.

15. Economic growth depends upon factor accumulation and improvements in total factor productivity (TFP). In recent years our understanding of factor accumulation has been broadened by a wider appreciation of the nature of capital. Physical capital has become less important, as knowledge or information-based products and services grow in value. Even in traditional industries, a growing information element may capture the majority of competitive advantage and be the source of most profit.[11] The "knowledge economy" is thus increasingly reliant on the accumulation of social and human capital (and this will be discussed in more detail in the next section).

16. The accumulation of physical capital depends on the rate of investment in an economy. FDI and other international capital flows have already been discussed, but domestic rates of savings remain crucial. In East Asia, for example, savings rates were exceptionally high during the years of rapid economic growth, allowing the level of investment necessary to sustain that growth. In other regions, however – Latin America is a good example – saving rates were much lower (18 percent of GDP compared to 34 percent in East Asia). In most developing countries, including those introducing economic reforms, investment rates have rarely surpassed 20 per cent of GDP. This is well below the 25-30 percent that appears to be needed to raise growth of income per capita to more than 5 percent per annum over the long term.

17. Many factors act to depress domestic savings. Government involvement in the market and inflation both discourage saving, while closed markets have given institutions little incentive to provide competitive terms to domestic savers. The policies discussed in Sphere 1 should thus have a beneficial effect on savings. Indices of democracy, and the rule of law, are also positively correlated with savings levels. The historically poor performance of many developing countries in these two areas largely explains low levels of investment in their economies. Policymakers also have an important role in making sure that there is adequate regulation of the investment market. This allows savers the open access to honest information essential for the market to perform properly.

[11] See for instance P. Evans and T. S. Wurster, "Getting Real About Virtual Commerce", *Harvard Business Review*, November-December, 1999.

18. It is not enough for markets to attract savers. They must also be able to deliver capital to those in need of credit. In many developing countries, the spread between the rates of interest paid to borrowers and those demanded from lenders is notably high, reflecting the inefficient and high-risk nature of their markets. In East Asia, for example, from 1990 to 1995, this spread averaged 4 per cent and typically ranged from 1 to 6 per cent, whereas it was many times higher in Latin America. As a result, lending activity across Latin America was low – with Latin American banks lending only 60 per cent of GDP from 1990–1995, compared to 83 per cent in East Asia and 106 per cent in the developed world. In Latin America, half of the credit went to the public sector, compared to upwards of 80 per cent to the private sector in East Asia and the industrialized democracies.

19. Policymakers therefore need to consider why *private* investment has remained low.[12] They can in turn facilitate a well-functioning financial sector by offering a stable and predictable macroeconomic environment as well as a regulatory environment that upholds the rule of law, respects private property, and promotes the enforcement of legitimate contracts. Prudential oversight of the banking system to ensure, for example, adequate bank capital, reserves for bad and risky loans, and restrictions on inside loans, are also necessary to inspire confidence in the system. Without such confidence, financial markets will be less active and savings will be concentrated offshore.

SPHERE 3:

Sustainable Human Development

20. The case for giving increased priority to sustainable human development (SHD) has been advanced on many fronts over recent years. Two main arguments have been made:

- That sustainable human development is the ultimate end of the development process, with economic growth simply representing an important means to that end. This view has been strongly advanced by the UNDP, which opened its first human development report thus: "the real wealth of a nation is its people. And the purpose of development is to create an enabling environment for people to enjoy long, healthy and creative lives. This simple but powerful truth is often forgotten in the pursuit of material and financial wealth."

[12] There are a large number of constraints to efficient public investment as well. Budget cuts in the context of macroeconomic adjustment policies have tended to fall disproportionately on public investment. Experience also shows that the managerial capacities of the public sector to undertake large investment projects are vastly overrated.

- Growing evidence that, as well as being the main objective of broad-based development, SHD is also an exceedingly powerful *instrument* of economic growth and development. Human and social capital are increasingly recognized as an economic input, not simply an output, and there is powerful evidence that these forms of capital are becoming more important in many developing economic sectors.

21. In discussing human and social capital, this paper notes the importance of both as legitimate ends to development, but also explores their role as a vital instrument in the development process itself.

Human Capital

22. The study of human capital focuses on the role of people in society, with increases in human capital improving the opportunities that people enjoy. Education, for example, increases social mobility, allows enhanced participation in a range of social activities, and has well-documented effects on health and perceptions of quality of life. It is also an important determinant of economic growth, offering clear private and public economic benefits. The better educated are more productive and have greater opportunities to succeed in the labor market. With the knowledge economy demanding ever-greater levels of skills from its workers, educated people are in turn better equipped to respond to changing market signals. This is especially important when an economy must re-structure. Asian countries with a strong developmental record during the latter half of the twentieth century have all placed a strong emphasis on improving both the quantity and the quality of their educational systems.

23. If education offers people *opportunity*, then health provides them with *security* – and its importance is increasingly being recognized.[13] The burden of poor health falls most squarely on the poor in any society. Not only are they least able to access quality healthcare, but they also rely most on their labor – and poor health quickly reduces people's ability to work. A health shock can quickly wipe out the savings of a poor or middle-income family in a developing country, while simultaneously decreasing investment in other forms of human capital (as a child is removed from school, for instance, both to save money and to act as a carer). Again, better health has measurable effects on the economy. Healthy people are better able to work, as well as more likely to save for their retirement and to invest in their (healthier) children's education. Improvements in health are likely to significantly improve the opportunities of the poorest in society.[14]

[13] David E. Bloom and David Canning, "The Health and Wealth of Nations," *Science*, February 2000.
[14] See David Bloom, David Canning, Bryan Graham, and Jaypee Sevilla, "Out of Poverty: Moving Beyond the OECD/DAC Targets," January 2000, which presents a "business as usual" scenario in which the global

24. A related factor is demographic change, which offers all developing countries (though few developed ones) favorable economic opportunities in the years to come. As life expectancy increases, there is a lag before people start to choose to have fewer children. However, once fertility declines, it does so steeply (though how steeply varies from country to country) as people choose to invest more resources in fewer children. This demographic transition is at the heart of the development process. When large families are common, universal education is difficult to provide. Further, rural families look to their children to become productive on the land from a young age. The role of women also changes rapidly when smaller families are common. They are more likely to receive education and to become more active outside the family. This in turn increases the opportunities available to children, who tend to receive better education and more access to resources as their mothers become more highly educated. Research shows that these processes can be accelerated by policies that actively promote the capability and autonomy of women and that seek to protect them from discrimination and physical abuse.

25. Demographic transitions also have economic effects. Reductions in mortality initially affect infants and children most and set forces in motion that create a bulge (or "baby boom") in the age distribution. More specifically, the mortality decline creates the leading edge of the bulge while the trailing edge is formed by the subsequent decline in fertility. Once this enlarged cohort has been educated, they become available to the labor market, causing a sharp rise in the ratio of workers to dependents. If these workers can be gainfully employed, then a country has an opportunity to seize a substantial one-off *demographic dividend*. This demographic dividend is intensified by the likelihood that the baby boom generation – with higher life expectancy and fewer children – is likely to save more if the right policies are in place.[15] It may also be more entrepreneurial in its attitudes, as a consequent shift from country to town and city promotes more individualistic attitudes.

Social Capital

26. The idea of social capital broadens human capital's focus on individuals to explore the importance of their relationships with others.[16] The Human Development

rate of absolute poverty, defined as people living on less than US$1 per day, drops from 28 percent in 1990 to 12 percent in 2015. The OECD poverty reduction targets, which call for a halving of levels of poverty between 1990 and 2015, are thus not very demanding. The study also presents evidence suggesting that further health improvements could contribute to an even more substantial reduction in poverty. On the other hand, poverty rates could rise in the face of an erosion of health gains, for example, as a result of an expanding HIV/AIDS epidemic.

[15] See David E. Bloom, David Canning, and Pia Malaney, "Demographic Change and Economic Growth in Asia," *Population and Development Review*, forthcoming 2000; David E. Bloom and Jeffrey G. Williamson, "Demographic Transitions and Economic Miracles in Emerging Asia," *World Bank Economic Review*, 1998, Vol. 12, No. 3, 419-55; and David E. Bloom and Jeffrey D. Sachs, "Geography, Demography, and Economic Growth in Africa," *Brookings Papers on Economic Activity*, 1998, Vol. 2, 207-295.

[16] For a wider discussion of social and human capital and their relationship to the globalization process, see *Social Capitalism and Human Progress*, David E. Bloom and River Path Associates, paper prepared for the OECD Forum for the Future conference on '21st Century Social Dynamics', Berlin, 6-7 December 1999, and to be published in a forthcoming OECD book. Also available at www.riverpath.com

Index, according to the UNDP, reflects "the most basic human capabilities – leading a long life, being knowledgeable and enjoying a decent standard of living". These are measured through life expectancy at birth, educational attainment (adult literacy rate and combined primary and secondary enrollment ratio), and income per capita. However (as the UNDP underlines), other "choices" are important to people, including political freedom and participation, the development of the family and the rights of women, social cohesion and disintegration (especially levels of crime and corruption).

27. Democratic government balances the rights and responsibilities of citizens – and seems to be the form of government best adapted to the modern world.[17] The strength and effectiveness of a democracy – and popular confidence in, and support for, its survival – has important implications for the quality of life people enjoy. Democracies also seem most suitable to fostering values relevant to successful, modern economies. The myth that pro-market reform can only be implemented under dictatorships has now been dispelled. Democratic governments have demonstrated that they are capable of designing and implementing far-reaching economic reforms, and that their politicians can build popular support for such reforms. In fact, without democracy, economic reform lacks legitimacy and can be easily turned back. It is also easier to foster widespread entrepreneurial attitudes within a democracy, as individuals enjoy the risks and benefits of taking responsibility for their own actions.

28. Strong democracies rely on institutional strength – which is also vital to economic development and the efficient functioning of markets, as the disastrous experience of the former USSR shows. Russian democratization and market liberalization were accompanied by rapid deterioration in almost all institutions and, as a result, the country faces economic decay, increasing poverty, and a precipitous decline in health status.[18] Even countries with functioning institutions cannot afford complacency. As the World Bank points out, successful organizations regularly reinvent themselves, "continuously adapting their internal rules, centralizing some functions, decentralizing others, adding discretion where advantageous, and modifying the criteria for rewards when doing so is likely to improve performance."[19] Many institutions find this process of continual reform difficult to achieve. Rich and poor countries alike are struggling with a reliance on outmoded institutions that continue to offer poor value and levels of service.

29. Social capital describes more than the formal relations in society, however. Indeed, many have argued that it is best confined to describing informal relations. For example, Francis Fukuyama argues that "social capital can be defined simply as a set of informal values or norms shared among members of a group that permits cooperation among them", but warns that the sharing of values and norms does not automatically

[17] The number of democracies increased rapidly in the last decades of the 20th Century. For a more detailed discussion see: Robert A. Dahl, *On Democracy*, 1998, Yale University Press.
[18] See Charles Becker and David E. Bloom, eds., *The Demographic Crisis in the Former Soviet Union,* Special Issue of *World Development*, November 1998.
[19] *Entering the 21st Century: World Development Report 1999/2000*, World Bank 1999.

produce social capital.[20] Some cohesive groups, for example organized criminal gangs, may substantially diminish a society's share of social capital. Unlike human development, social development is thus much harder to analyze and measure. It is also much more difficult to say which social *change* is likely to contribute to significant levels of social *development*.

30. The family is the primary unit of social capital. The family is experiencing change throughout the world, as a result of the linked processes of demographic change, increased urbanization, a reassessment of the rights of women and children, and increased individualism. Family change results in many contradictory pressures. For example, according to the UNDP, Norway, Sweden, and Denmark offer women the widest range of opportunities. However, they also have exceptionally high rates of births to single mothers (running at over 46 percent of all births in Denmark[21]), suggesting that the bulk of parental care responsibilities continue to fall to women. The United Nations Children's Fund (UNICEF) rates the quality of care as the third most important factor in preventing child malnutrition (after household security and access to water, health care and sanitation facilities), while UNDP estimates that women spend some two thirds of their working hours in unpaid work compared to men, who spend only a quarter. It describes the "feminization of the labor force" as offering women only mixed benefits, and argues that globalization is actively degrading standards of care.[22] Conservative commentators, meanwhile, argue that family change itself is reducing standards of care. Women are now more able to support divorce as a marriage outcome due to their economic dependence, while fewer children mean many couples have less joint capital invested in the marriage.[23] Meanwhile Fukuyama notes that women's economic positions after divorce tend to be far worse than that of men, and also cites evidence that children with divorced parents are more likely to suffer from physical and sexual abuse.

31. The nature and function of the family has strong – but highly complex – relationships to economic development. For example, the shift from rural to urban living and the resulting break-up of the extended family naturally results in more people saving larger sums for their retirement. Children, in turn, are much less likely to work as they spend more time in school. This increases the likelihood that they will find high-productivity jobs in later life. With fewer children, more women are able to work, thus reducing the dependency ratio – offering society the opportunity to benefit from a "gender dividend". Women are also likely to demand more education, in order to enhance their value in the workplace. Additionally, educated mothers pass on vital skills to their children, especially in the pre-school years. Women also tend to spend a higher proportion of their income within the family, much of it on investment in children's futures. Further, women seem to be much better at sharing information, such

[20] Francis Fukuyama, *The Great Disruption: Human Nature and the Reconstitution of Social Order*, The Free Press (1999).
[21] Ibid.
[22] "The expansion of markets tends to penalize altruism and care. Both individuals and institutions have been free-riding on the caring labor that mainly women provide. Whether women will continue to provide such labor without fair remuneration is another matter." *Human Development Report 1999*, Op. Cit.
[23] See for example, Gary S Becker, *A Treatise on the Family*, Harvard University Press, 1991.

as medical knowledge, which in turn adds to their family’s security.

32. Levels of social capital also determine the ability of people to work together effectively[24]. These working relationships can take many forms, depending on common interpretations of the rights and responsibilities of different sections of society. Many successful economies have seen a rise in entrepreneurship as individuals' understanding of work has changed. Indeed, the willingness of the individual to assume risk has significant economic consequences. The Global Entrepreneurship Monitor (GEM), an initiative studying levels of entrepreneurship in 9 developed countries, has found significant differences in levels of entrepreneurship and in public attitudes to entrepreneurial opportunity. It estimates that variations in rates of entrepreneurship between societies could account for as much as 36% of the difference in the speeds at which different economies grow. Changing attitudes to entrepreneurship is not easy, however, with GEM estimating that "it may take decades of sustained changes in national, cultural, political and economic institutions…to join the 'elite' of entrepreneurial countries."[25] Nevertheless, new technological developments promoting active and worldwide communication opportunities, such as the Internet and mobile telephony, offer hope of a more optimistic outcome in which the process of cultural change is accelerated.

Interactions

33. None of the three policy spheres can be developed in isolation. Fast economic growth is exceedingly difficult to achieve in isolation from global markets. Technology now advances too rapidly for any country to proceed alone, and knowledge shows little respect for national borders. Policies to encourage openness, however, are impossible to sustain without economic growth. Global markets change fast and demand economies that are responsive to their signals. Sluggish economies will not experience sufficient benefits from liberalization to offset the inevitable costs. 34. The consequences for all societies, and especially for democracies, will be growing protectionist pressures and reversals of liberal policies.

34. Nor can economic development be seen in isolation. Sustainable human development (SHD) is the ultimate aim of development policy, but it is also a vital route to economic development and to enabling a society to benefit from openness. However, SHD cannot occur appreciably without economic growth. While it is possible for a society to get richer without its poorest people seeing their prospects improve, it is unheard of for large numbers of people to escape poverty while a society suffers economic reverses. Equally, an open society offers many advantages to those trying to achieve human development. Enhanced communication and a greater awareness of living conditions in other societies is a fundamental threat to repressive regimes – and liberal policies stress individual responsibility, which is impossible to achieve when human and social capital has been diminished.

[24] Fukuyama argues that competitiveness relies on "groups of individuals who, because of a preexisting moral community, are able to work together effectively." Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity*, Free Press, New York, 1995.

[25] P.D. Reynolds, M Hay, S.M. Camp, 1999 Executive Report, Global Entrepreneurship Monitor, Babson College, Kauffman Center for Entrepreneurial Leadership, London Business School.

35. By working at the intersection between the policy spheres – and creating a balanced policy portfolio – policymakers can seek to set up a positive feedback loop between different policy elements. By delivering sustained improvements in health, for example, policymakers will create a direct effect on demography, investment in education, physical capital accumulation, and the efficient functioning of the labor market. Further, smaller families spend more on the health of their children. And just as the educated are better able to extract benefits from health systems, as well as be more receptive to preventive health messages, so do those with productive jobs spend more on nutrition and healthcare.

36. Similar interactions can be seen across all policies. Formal analysis, for example, has been used to explore the interaction between demography and liberalization. In a country with a working age population growing at 3 percent a year (and twice the pace of overall population growth) the demographic dividend is three times greater – boosting growth by 1.5 percent compared to 0.5 percent if an economy is not open to world trade.[26] Policymakers should therefore strive to achieve *virtuous spirals* whereby the outputs of interactions between policy elements generate a resonant and ascending set of development benefits. Conversely, policymakers must also act quickly and decisively to tackle a serious deterioration in any policy area, as this risks starting a *vicious spiral* causing declines across other indicators. In Sub-Saharan Africa, for example, the AIDS epidemic is having a dramatic effect on life expectancy, the productivity of the workforce, and the ability of parents to invest in their children's future. As a result, the wider prospects of the region are diminishing rapidly.

37. Theories of virtuous and vicious spirals of development have led to increasing demands for a holistic approach to development, with policy-makers working to achieve a comprehensive set of development gains. The World Bank's Comprehensive Development Framework (CDF), currently at a pilot stage[27], is one example of this approach.

'Holistic' or realistic?

38. The comprehensive approach to development raises some serious questions. There are three main issues:

39. First, despite the many positive interactions between economic, social and human development, it cannot be assumed that the needs of each will always pull in the same direction. Globalization, according to the UNDP, is creating "new threats to human security – sudden and hurtful disruptions in the pattern of daily life", and many contend that global and national economic interests will not always be aligned. From this perspective, measures to restrict or regulate the operation of free markets are needed.

[26] David E. Bloom, David Canning, David Evans, Bryan Graham, Patrick Lynch, and Erin Murphy, "Population Change and Human Development in Latin America," background paper prepared for Inter-American Development Bank, *Economic and Social Progress in Latin America, 1999-2000 Report.* forthcoming 2000.

[27] *Entering the 21st Century: World Development Report 1999/2000*, World Bank 1999.

40. In contrast, others (generally on the political right) have argued strongly that the ability to participate in free markets is itself a vital human freedom (a view supported by Amartya Sen[28], who also argues for the importance of "transactional freedom" (i.e. freedom to participate in the marketplace). From this perspective, limits to markets restrict human opportunity and development, as market systems are thought to offer a form of spontaneous order superior to any that can emerge from a centralized hierarchy. F.A. Hayek, for example, famously described as a "fatal conceit" the idea that "the allocation of resources is better accomplished through bureaucracy and regulation than through the marketplace".[29] Following the collapse of communism, Hayek's views are received more sympathetically across the political spectrum. However, the experience of the ex-communist countries has also indicated that markets function best within highly advanced societies, where they are sustained by formal regulation, informal norms, and trust. Achieving a balanced approach between the demands for regulation and deregulation will not be easy – especially in countries whose economies are either developing or deteriorating rapidly.

41. There is equal potential for conflict between social and human development. In reviewing Amartya Sen's *Development as Freedom*, Richard N. Cooper criticizes Sen for failing to tackle how to balance the freedom of the individual against a society's need for security and stability.[30] Fukuyama also highlights potential conflicts between the rights of individuals and the needs of society. "Strong" social bonds (within families and in traditional communities, for example) may increase social stability, strengthen the family, and provide greater security for community members. Societies where these 'strong bonds' have been weakened may develop ever-larger numbers of 'weak bonds', as people associate more broadly, but less deeply.[31] As a result, levels of trust outside families may increase, encouraging entrepreneurship and a greater sense of individual opportunity. However, a "great disruption" of rising crime levels, distrust in traditional institutions, and family breakdown may result.

42. The second issue concerns attempts to make simultaneous progress on many fronts. There is a very real danger that an overly broad view of development will result in a "policy paralysis". The Comprehensive Development Framework calls on each country to "own its development strategy" and to determine the goals, timing, and sequencing of its programs. Simultaneously, countries are exhorted "to build partnerships" with a large number of actors, while also developing "a long term vision" with national support. Further, "structural and social concerns should be treated equally and contemporaneously with macroeconomic and financial concerns." In many cases, however, governments already lack the resources and capabilities to implement policy options. All policy change is costly, demanding the sustained application of highly skilled human resources in order to develop concrete and specific action from generic solutions – and then to embody them in enforceable laws and administrative procedures. International development organizations, meanwhile, have been criticized

[28] Sen, op. cit.
[29] Friedrich A Hayek, *Fatal Conceit: The Errors of Socialism*. University of Chicago Press, 1998.
[30] Richard N. Cooper, *The Road From Serfdom, Foreign Affairs,* 79:1. January/February 2000.
[31] Geoff Mulgan, *Connexity: How to Live in a Connected World,* Harvard Business School Press, 1998.

for their inability to provide evidence of demonstrable successes. As the Overseas Development Council has noted: “The problems in the current system of aid delivery at the country level have been well studied, and recent reviews have highlighted and quantified the ineffectiveness of aid in promoting growth and poverty reduction.”[32] If they have failed to deliver narrowly-focused programs effectively, then a comprehensive approach could prove impossibly demanding. This problem seems even more serious when the defining characteristic of the global economy is a requirement for speed. In the business world, one management theorist has described modern business as like baseball, “a fast and fluid game”, explaining that businesses can no longer afford five year plans, when “it’s more like a five-week schedule inside a five-month plan inside of a fifteen-month intuition.”[33]

43. The third issue concerns the sources of legitimacy for a comprehensive development approach. Many development assistance organizations have entered the new century with a strengthened remit to focus on poverty reduction, often adopting the OECD/DAC poverty reduction targets. Their assistance therefore comes with a very clear agenda attached. Recipients, meanwhile, are more likely to have democratic governments, and must set their policy focus according to the demands of voters. In a democracy, unpopular policies are only sustainable over the short term (usually less than an election cycle) and must command support from the electorate over the medium and long term. Policy-makers must therefore do more than design and deliver their policy portfolios from on high, especially when many necessary policies involve short term costs (economic re-structuring is usually costly to some groups, while investment in human and social capital requires short term expenditure for long term gains). In the Human Development Report, Paul Streeten argues that “what matters most to [poor people] often differs from what outsiders may assume” and that “non-material benefits are often more highly valued by poor people than material improvements.” It is questionable whether this argument for giving priority to human development will stand up in many democracies, as economic growth tends to be highly popular with voters. Some suggest that governments should be firmer in setting priorities to meet the needs and demands of their electorate, for example the World Bank study of Sector Investment Programs, which argues a requirement for “government with the will-power to say to donors: ‘Here is my program in this sector: if you wish to help me implement it, you are most welcome. If you wish to do something different, I regret that you are not elcome in my sector in this country.’”[34]

[32] Ravi Kanbur and Todd Sandler with Kevin M Morrison, *The Future of Development Assistance: Common Pools and International Public Goods*, Policy Essay No. 25, Overseas Development Council, Washington DC. John Hopkins University Press, 1999. The essay refers readers to the World Bank’s influential *Assessing Aid: What Works, What Doesn’t, and Why*, World Bank Policy Research Report, Oxford University Press, 1998.

[33] For a wider discussion on the importance of rapid responses in the current business environment see: S Davis and C Meyer. *Blur: the Speed of Change in the Connected Economy*, Perseus Books, Reading, Mass. 1998.

[34] Cited in: Ravi Kanbur and Todd Sandler with Kevin M Morrison, *The Future of Development Assistance: Common Pools and International Public Goods*, Policy Essay No. 25, Overseas Development Council, Washington DC. John Hopkins University Press, 1999

ACTION POINTS

44. The concept of the virtuous spiral provides a route out of this impasse, offering the opportunity to take complexity into account, act in a definite and limited number of directions, and adopt a number of different approaches. Instead of advancing on all fronts, governments identify strategic points of entry that can be used to push the spiral into action. As the first benefits are released, it is important to ensure that they then spread into other areas of the policy portfolio. Balance, in other words, is most practically achieved as a *dynamic* process, rather in the way that a cyclist stays upright by continually adjusting to a permanent state of disequilibrium.

45. One consequence of this approach is to sound a (long overdue) death knell for the single model of development, which has tended to express itself at any one time as both fixed and dogmatic ("this is the right way to do it"), but which has also, over time, proceeded to change with the intellectual fashion *du jour*. Instead, there are now multiple models that can deliver results (though there are many more models that are unlikely to be successful). There is also some evidence that a bias towards human development is more likely to start the spiral moving than a bias towards short-term economic growth. Alejandro Ramirez, Gustav Ranis, and Frances Stewart argue that countries displaying "economic growth lopsidedness" moved to virtuous spirals in around a third of cases, while all cases of "economic growth lopsidedness" resulted in only temporary gains.[35] They also suggest that models need to change as progress is made, with basic health and education favored in the earliest phases, but resources gradually being shifted towards science, technology, and more advanced education. They also note that labor-intensive rural employment may be an initial priority, but economic growth in higher-productivity sectors will be essential to sustain growth.

46. Currently, it is possible to identify a number of strategic points of entry that offer policymakers an opportunity to make significant development progress. Examples include:

- *Tackling social exclusion*. To date governments have been less than successful in shielding the most vulnerable groups in society from the disruption of pro-market reform. Reforms are therefore threatened by rising inequality. Measures to tackle social exclusion have two aims. The first is to increase the security of the socially excluded through safety nets protecting the vulnerable members of society from the inevitable social side effects of a liberalized market economy.[36] These safety nets should be structured to induce individuals and groups to move towards increasingly independent and risk-taking behavior, rather than simply encouraging dependency (as, for example, have many developed country welfare systems). The

[35] Alejandro Ramirez, Gustav Ranis and Frances Stewart, *Economic Growth and Human Development*, Yale University Economic Growth Center Discussion Paper No. 787, December 1997.
[36] For a similar view, see D. Rodrik, *Has Globalization Gone too Far?*, Institute for International Economics, Washington, D.C., 1997.

second aim is to enhance opportunities by offering the excluded a range of ways to increase their participation in society, through education, support for small businesses, micro-credit facilities, and so forth.

- *Poverty reduction* – inequality is a significant drag on society, especially in countries where a significant minority, or a majority, of people lives in poverty. Poverty is associated with higher fertility, which impedes the demographic transition. It also diminishes demand for education. In Brazil, for example, it is estimated that school enrollments would be 40% higher than they are if Brazil's income inequality were equal to that of Malaysia. Large numbers of poor people also make a country more vulnerable to disasters and to internal wars. Sri Lanka, for example, is frequently praised for the priority it has given to human development. Poverty levels, however, remain high, a civil war has cost tens of thousands of lives, and few would claim the country has made broad development gains in recent years. The UNDP recommends that pro-poor growth should focus on: restoring full employment; removing anti-poor biases from the macroeconomic framework; investing in the capabilities of poor people; ensuring access of poor people to resources, including credit; increasing the productivity of small-scale agriculture and small businesses; and promoting labor-intensive industrialization.

- *Support for small business*. The small business is increasingly important to modern economies, but many small businesses – especially in developing countries – suffer from low productivity, lack of skills, and archaic methods of production. In fact, many such "businesses" are no more than a symptom of disguised unemployment. Action to strengthen the small business sector can help mitigate unemployment by transforming underemployed workers into self-employed entrepreneurs, who may eventually employ others, while improving skills, increasing access to technology, and providing availability to credit for working capital and investment. Action targeted at potential entrepreneurs is effective even when people move into other

- forms of employment, helping creating employees with the "intrapreneurial" attitude that modern businesses value. Most exciting, today's first generation entrepreneurs may breed a second generation with vastly increased ambition and scope. In India, for example, small computer businesses – often attracting investment from expatriates living in the USA – are driving a rapidly growing high technology sector, conservatively expected to earn US$50 billion in exports by 2008.[37]

[37] *India: Information Technology*, Financial Times Survey, December 1st, 1999.

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- *Higher education*. Today higher education has become, in many ways, the basic education of the knowledge economy. Yet developing country higher education systems remain poorly resourced and structured. Urgent action is therefore needed to plan their expansion and diversification as well as to build systems that will meet the requirements of tomorrow's world. Enhanced higher education will not only lead to better trained graduates, it will also provide developing countries with important points of contact to the global economic 'commons' as well as exerting upward pressure on education *quality* throughout the rest of the education system.[38]

- *Action on health*. As argued above, improved health is crucial to combating poverty, while health shocks can threaten the whole development process. Action on health is especially suitable for international action, as successful immunization programs have shown. There are many areas where renewed action is needed. In Eastern Europe, for example, deteriorating health (along with the breakdown of governance) is at the heart of the disastrous performance of many countries.39 HIV/AIDS, meanwhile, can be tackled through education and effectively marketing health messages (as the examples of Uganda and Thailand show). A renewed global campaign, with substantial private sector involvement, could have a huge impact on the prospects of much of the developing world.[40] An especially contentious area, needing international discussion and action, is access to pharmaceuticals. Once a drug is developed, the cost of producing it is low, and there is surely scope to exploit the difference between the market price and marginal costs to ensure that people the world over can have access to drugs that can make them happier and more productive. However, pharmaceutical companies are naturally unwilling to invest in drugs whose primary market will be in the developing world, because of the difficulty in marketing them profitably. Equally, attempts by drugs companies to "donate" drugs to developing countries (for example, malarone for malaria) have sometimes proved to be exceptionally frustrating experiences, with such donations attracting considerable argument about distribution channels and protocols among, for example, both the World Health Organization (WHO) and national governments.[41] Imaginative solutions to this problem,

[38] Task Force on Higher Education. *Peril and Promise: Higher Education in Developing Countries*. Forthcoming 2000, Washington, D.C.: The World Bank.
[39] See Becker and Bloom, op. cit.
[40] D.E. Bloom, A. Rosenfield and River Path Associates (1999). A Moment In Time – AID$ and Business, American Foundation for AIDS Research (amfAR).
[41] By contrast, Merck's provision of Ivermectin for river blindness has been remarkably successful and beneficial. However, even in this case there were problems. A decade after the discovery of Ivermectin's remarkable impact on river blindness, only 3 million of 120 million people at risk had received the drug, as the WHO claimed it didn't have money to cover distribution costs. Interestingly, Roy Vagelos, then Chairman of Merck, was initially reluctant to give away the drug "as we feared it would discourage companies from doing research relevant to the Third World, since they might be expected to follow suit."

alongside concerted action on HIV/AIDS and on vaccine development and distribution, could form the basis for a future international compact on health.

- *Institutional renewal*. The need for new forms of governance has already been discussed. In a global economy, there is also a need for strong international institutions as well as for action to equip national institutions to engage more effectively within the global system. The disastrous recent World Trade Organisation (WTO) negotiations in Seattle demonstrated how much work there is to be done. The negotiations revealed widespread public disillusion with globalization, showing how poorly policymakers have articulated the case for openness. They also revealed damaging splits between developed and developing countries. Developing countries have been told that liberalization is the best policy, but they have not always found markets in developed countries opening for them. Many developing countries have also been shown to lack the capacity to negotiate effective agreements. Technical and financial assistance is also clearly needed to help countries implement new trade rules and to adapt to new requirements in the North, which while they may be intended to improve consumer protection, are all too often criticized from the South's perspective as examples of, in effect, covert protectionism.

CONCLUSION

47. Poised on the threshold of a new century, policymakers across the world have a great opportunity – and responsibility – to help define this new epoch. The last century delivered a number of major improvements to the lives of many of the world's poor, disadvantaged, and excluded. Yet there is still much work to be done. New technology has profound implications. It can help disseminate decades of developmental 'knowledge capital', and open up an incredible range of new opportunities. Equally profound, however, is the responsibility on all of us to help ensure those opportunities are used to deliver a liberal, global, and humane future for all our planet's inhabitants.

Millions for Viagra, Pennies for the Diseases of the Poor, Ken Silverstein, The Nation, July 19, 1999. (www.thenation.org)

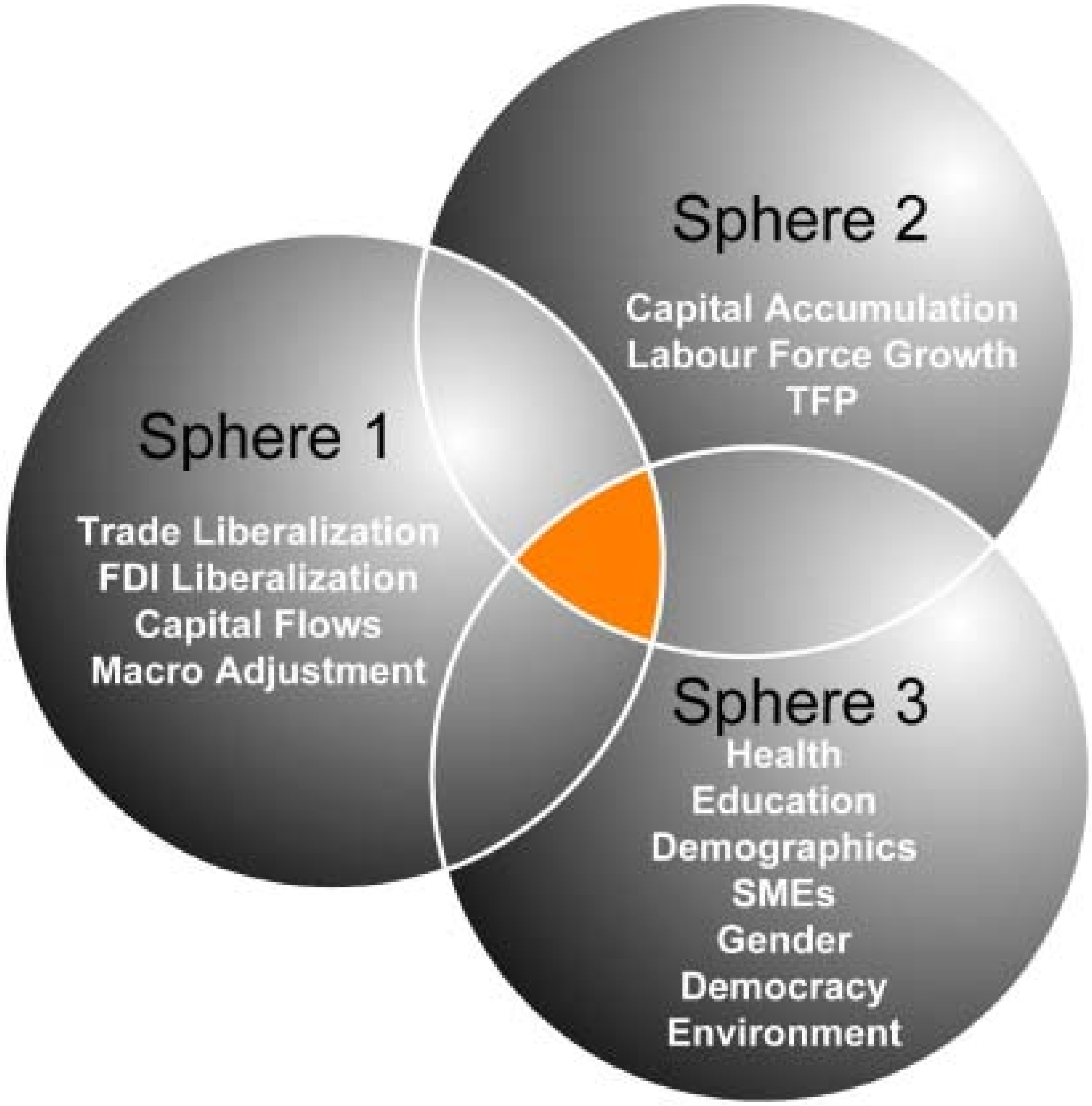

Figure 1
FDI: Foreign Direct Investment
TFP: Total Factor Productivity
SMEs: Small to Medium sized Enterprises