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POVERTY AND DEVELOPMENT

by

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ABSTRACT

The paper distinguishes three types of poverty -- mass poverty, conjunctural poverty and destitution -- from the historical record, and how they have been dealt with. It emphasizes that the only cure for mass poverty is modern economic growth. It outlines the ethical underpinnings of two different perspectives for dealing with problems of destitution and conjunctural poverty. The final two parts of the paper survey the empirical evidence on the success of the efficient labor-intensive growth, and the evidence from the Lal-Myint comparative study of the results from the creation of welfare states in some Third World countries -- the so-called direct route to poverty alleviation.

JEL classification: I3, N3, O15

INTRODUCTION

This paper primarily summarizes the findings on poverty and development from a 21 country comparative study of the political economy of poverty, equity and growth that Hal Myint and I have conducted for the World Bank over the past seven years.[1] Given the limitations of space various important questions concerning measurement issues are ignored.[2]

The paper is in four parts. In the first part three different causes of poverty are identified from the historical record, and the ways they have been dealt with are briefly outlined. The second part outlines two different perspectives and their ethical underpinnings for dealing with problems of destitution and what has been labelled conjunctural poverty. The third part looks at the empirical evidence on the so-called indirect route to the alleviation of structural or mass poverty-the promotion of efficient labor intensive growth. The final part examines the evidence from the Lal-Myint studies of the results from the creation of welfare states in some countries in the Third World. This is the implicit aim of the so-called "direct" route to poverty alleviation. It pays particular attention to questions of political economy.

I. THREE TYPES OF POVERTY

Structural Mass Poverty

For most of his history poverty has been the natural state of Man.[3] Until the end of the 19th century when the power of the Unbound Promethus was at last becoming manifest with the rolling Industrial Revolution, few economists held out the prospect of alleviating mass poverty. Classical economics with its law of diminishing returns and the Malthusian principle of population predicted a long run stationary state where the mass of people languished at a subsistence standard of living. This as Wrigley (1988) has shown in a brilliant book was due to their belief that they were still concerned with the age-old problem of the development of an organic economy, which Wrigley defines as "an economy bounded by the productivity of land" (p. 5). In such an economy -- and historically this has been the dominant type over the globe -- there is a universal dependence on organic raw materials for food, clothing, housing and fuel. Their supply is in the long run inevitably constrained by the fixed factor -- land. This was also true of traditional industry and transport. Most metal working industries were dependent upon charcoal (a vegetable substance) for smelting and working crude ores. Whilst:

> since many branches of industry, most mining ventures and almost all forms of transport, as well as agriculture, made extensive use of animal muscle as a source of mechanical energy, the productivity of land was crucial to the supply of power as well as heat. Woodland and pasture were as necessary to English industry as her arable land was to the family table. A recognition of the significance of the productivity of land to the whole range of productive activities of society is both implicit and explicit in the writings of the classical economists, and the leverage which the application of the principle of declining marginal returns thus exacted was very powerful. (pp. 18-19)

The system of "capitalism" and free trade outlined and defended by Adam Smith could increase the productivity of the organic economy somewhat over what it was under mercantilism. It would also help the poor by lowering the cost of their consumption bundle, whilst boosting their wages as producers, but if this increase in popular opulence led to excessive breeding, the land constraint would inexorably lead back to subsistence wages. Technical progress could hold the stationary state at bay but the land constraint would ultimately prove binding.

The Industrial Revolution led to the substitution of this organic economy by a mineral based energy economy. But this fundamental change was only becoming apparent towards the mid-19th century in England, and it was not until Marx was writing that it had become manifest. This new economic regime "escaped from the problem of the fixed supply of land and of its organic products by using mineral raw materials" -- in particular coal. It began to provide most of the heat energy of industry, and with the development of the steam engine virtually unlimited supplies of mechanical energy. "The prospects for growth both in aggregate output and in output per head were entirely transformed from those which had always previously obtained" (Wrigley, pp. 5-6).

Thus the Industrial Revolution in England was based on two forms of "capitalism", one institutional, namely that defended by Adam Smith -- because of its productivity enhancing effects, even in an organic economy -- and the other physical: the capital stock of stored energy represented by the fossil fuels which allowed mankind to create a

> world that no longer follows the rhythm of the sun and the seasons; a world in which the fortunes of men depend largely upon how he himself regulates the economy and not upon the vagaries of weather and harvest; a world in which poverty has become an optional state rather than a reflection of the necessary limitations of human productive powers. (Wrigley, p. 6)

Not only the subsequent experience of the First, but of many countries in the Third World has borne this out. It is possible as many countries in Southeast Asia for instance have shown to eradicate mass poverty within a generation, because neither of the twin foundations of the gloomy classical prognostications, diminishing returns (see Scott (1989)), nor the Malthusian principle (see Birdsall (1989)) on the demographic transition) are secure. A liberal economic order which promotes labor intensive growth can cure the age long problem of structural mass poverty.[4]

This, however, has led to concerns about two different sources of poverty -- that of destitution, and of those who due to conjunctural problems find themselves temporarily in poverty. Both these sources of poverty have existed over millennia though the sources of conjunctural problems have changed.

Destitution

It is worth noting that, traditionally, when mass structural poverty was the norm for mankind, the problem of "poverty" was seen as being confined essentially to destitution (see Himmelfarb, 1983; Iliffe, 1987). As until fairly recently most organic economies have also been labor scarce and land abundant economies, the primary cause for people falling into destitution was a lack of labor power (either their own -- because for instance of physical disabilities -- or from family members -- because they have no families) to work the land. This remains a major source of destitution in land-abundant parts of Africa (Iliffe, op cit., p. 4). In this world the poor are the destitute who are recognized as "deserving", whilst, as the Elizabethan poor law noted, any "able-bodied" poor were to be classified as vagrants.[5]

With population expansion and the emergence of land scarce economies in Europe and in many parts of Asia, there arose "the poverty of the able-bodied who lacked land, work, or wages adequate to support the dependents who were partly responsible for their poverty" (Iliffe, p. 5). Their poverty merges with the mass structural poverty we had discussed before, and growth will, as it has, lead to its amelioration.

Conjunctural Poverty

This leaves conjunctural poverty. For most of history, as economies have been organic agrarian economies, this form of poverty was linked to climatic crises or political turmoil. Its most dramatic manifestation was in the form of a famine. Since the Indian Famine Code was devised by the British Raj in the late 19th century, it has been known that to deal with what Sen (1982) labels "entitlement failures" which precipitate a famine, it is necessary for the government to provide income directly (through public works or food for work schemes for instance) to those who have suffered this temporary loss of income generating employment. As the Indian example shows, except for one exception this administrative solution has eliminated famines. But this solution does require political stability and a relatively competent administration. Without these it is not feasible.[6]

Hence, nowadays, famines are caused by politics. This is supported by examining the major post war famines: the one in China followed the political Great Leap Forward, and has been described as the worst in human history, costing 63 million lives (actual and prospective -- through lost or postponed births) (see Lin (1990)); the Sudanese and Eritriean famines, were due to civil wars in which famine was a political weapon used by the State against secessionists; and the Somali famine which has resulted from the collapse of that country into a Hobbesian state of nature.

Finally, the Industrial Revolution has introduced its own source of conjunctural poverty in the form of the trade cycle and the unemployment that ensues in its downturns.

Traditional Means of Alleviating Poverty

Historically, the destitute poor survived through four means. The first were through institutions like the Church which took one of its primary tasks to be the care of the poor. Individual charity provided a second means, whilst a third was organization by the poor themselves, either by underworld groupings or by self-help organizations like rotating credit associations. "Finally, historians have stressed that the poor relied less on institutions or organizations than on their own efforts, devious, ugly, cruel, and dishonest as these might be." (Iliffe ,p. 7)

Various implicit forms of insurance embodied in interlinked contracts in factor markets, have historically been the major way of dealing with conjunctural poverty in traditional village economies. (See Platteau (1991) for a survey and references to this literature.) They are still of importance in the highly risky environment faced by rural agents in many parts of South Asia (see Bardhan (1980) for a survey).

II. TWO ETHICAL AND POLITICAL TRADITIONS AND POVERTY ALLEVIATION

All these traditional ways of dealing with destitution and conjunctural poverty were gradually superseded in most Western societies by the evolution of the Welfare State. As the socialist impulse, strengthened by the appeal of Marxism in the late 19th century, provided an important intellectual impetus to these developments (see Himmelfarb op. cit.), not surprisingly the socialist ethic of egalitarianism got muddled with the age-long impulse to alleviate absolute poverty. Its apotheosis were the socialist economies that were set up in the Soviet Union, China and Eastern Europe, and which sought to subserve this end by socializing the means of production. The Western socialists who advocated welfare states, by contrast, sought to socialize the results of production. I have dealt with the problems of designing a social policy once the collapse of socialist economies has discredited their brand of egalitarianism, in an earlier conference at this Institute (Lal (1992)). So I can be brief in outlining the essential ethical and thence policy differences which underlie the continuing tension between Western socialists seeking to equalize people -- albeit within the context of a market economy, and classical liberals who see the two ends of poverty alleviation and egalitarianism as distinct.

Classical Liberalism

For the classical liberal it is a contingent fact that there is no universal consensus on what a "just" or "fair" income distribution should be, despite the gallons of ink spilt by moral philosophers on trying to justify their particular prejudices as the dictates of Reason. Egalitarianism is therefore to be rejected as the norm for deriving principles of public policy (see the essays in W. Letwin (1983)) for reasons why egalitarianism is incoherent, and Hayek (1988) for why it is incompatible with a market order).

This does not mean that classical liberals are immoral! The greatest of them all Adam Smith after all wrote The Moral Sentiments. Both of the great moral philosophers of the Scottish Enlightenment -- Smith and Hume -- recognized benevolence as the primary virtue, but they also noted its scarcity. However, as Smith's other great work The Wealth of Nations showed, fortunately, a market economy which promotes "opulence" does not depend on this virtue for its functioning. It only requires a vast number of people to deal and live together even if they have no personal relationships, as long as they do not violate the "laws of justice". The resulting commercial society promotes some virtues (what Shirley Letwin (1992) has labelled the "vigorous virtues") -- hard work, prudence, thrift and self-reliance -- which as they benefit the agent rather than others are inferior to altruism. But, by promoting general prosperity, these lower level virtues do unintentionally help others. Hence, the resulting society is neither immoral or amoral.

Thus a good government is one which promotes opulence through a policy of promoting natural liberty by establishing laws of justice which guarantee free exchange and peaceful competition. The improvement of morality being left to non-governmental institutions.[7] But since Smith, down to Friedman and Hayek, classical liberals have also recognized that society or the State should seek to alleviate absolute poverty, which as Friedman has argued has a public goods aspect to it (see Friedman (1962) p. 191). Like the other public goods -- law and order, defense, a sound currency -- it is necessary to ensure that the State provides them at least cost (in terms of revenue) and that it does not expand beyond these limits into a revenue maximizing Leviathan.

On the classical liberal view, therefore, there is an externality, whereby "the recipient's consumption of particular goods or services (food, education, medical care, housing) or his attainment of certain states (being better nourished, better educated, healthier, better housed) that are closely correlated with an 'adequate consumption of such goods" (Harberger (1984)) enters the donor's utility function. As it is the specific consumption of these commodities, not the recipient's "utility" which enters the donor's utility function, there is no "utility" handle which can be used as on the alternative distributivist view to allow distributional considerations to be smuggled into the analysis of poverty alleviation programs.

Thus the indigent and the disabled are to be helped through targeted benefits. For various merit goods- health, education and possibly housing -- these involve in-kind transfers. This is very much the type of social policy package that was implemented in Pinochet's Chile, and which succeeded not only in protecting the poor during Chile's arduous transformation to a liberal market economy, but also led to dramatic long-term improvements in its various social indicators (see Castaneda (1992) for a detailed account of these social policy reforms and their outcome).

Distributivist Egalitarianism

The alternative technocratic approach to poverty alleviation is by contrast necessarily infected with egalitarianism because of its lineage. At its most elaborate it is based on some Bergson-Samuelson type social welfare function. Given the ubiquitous assumption of diminishing marginal utility underlying the approach, any normative utility weighting of the incomes of different persons or households leads naturally to some form of egalitarianism. But this smuggling in of an ethical norm which is by no means universally accepted leads to a form of "mathematical politics". Poverty alleviation becomes just one component of the general problem of maximizing social welfare, where given the distributional weighting schema, all the relevant tradeoffs between efficiency and equity, including inter-temporal ones can be derived in terms of the appropriate distribution cum efficiency shadow prices (see Little-Mirrlees (1974), Lal (1981)). If the concern is solely with those falling below some normative "poverty line", this merely implies a different set of weights with the weight of unity say to changes in consumption (income) above the line, and increasing weights to those who fall progressively below the poverty line. (See Ravaillion (1992) for a full explication of this approach in the design and evaluation of poverty alleviation programs in the Third World.)

But this is a thin edge of a very big wedge, as far as the defenders of the market economy are concerned. Besides leading to recommendations for all sorts of redistributive schemes, it also leads to a vast increase in dirigisme. To alleviate poverty, an end embraced by classical liberals, they are on this route being led to endorse the creation of a vast Transfer State, which in the long run is incompatible with the preservation of a market economy (see below).

The State as an Enterprise versus Civil Association

Reinforcing the different ethical perspectives from which the divergent programs for poverty alleviation on the classical liberal and the technocratic-distributivist programs emerge, are two divergent views about the role of the State and its relationship to society. As indigenous political traditions in most of the non-Western world have been snuffed out by those deriving from the West, it is not surprising that it is two alternative Western conceptions of the State which are now in contention worldwide.

In a brilliant historical analysis of the origins of the Western State, Michael Oakeshott (1975) has argued that these two conceptions of the State, have deep roots in Western thought. One view which goes back to ancient Greece, views the State as a civil association. The State is seen as the custodian of laws which do not seek to impose any preferred pattern of ends (including abstractions such as the general (social) welfare, or fundamental rights), but which merely facilitates individuals to pursue their own ends. This view has been challenged by the rival conception of the State as an enterprise association -- a view which has its roots in the Judaeo-Christian tradition. The State is now seen as the manager of an enterprise seeking to use the law for its own substantive purposes, and in particular for the legislation of morality. The classical liberalism of Smith and Hume entails the former, whilst the major secular embodiment of society viewed as an enterprise association is socialism, with its moral aim of using the State to equalize people.

The efficacy of any State viewed as an enterprise association (particularly of a benevolent kind) in serving the public weal is undermined by the implausibility of the assumption it makes about the character of its agents. The philosophers of the Scottish Enlightenment were clearheaded about the implausibility of viewing the State as a committee of Platonic Guardians. As Hume wrote in his essay "Of the Independence of Parliament":

> Political writers have established it as a maxim that, in contriving any system of government and fixing the several checks and controls of the constitution, every man ought to be supposed a knave and to have no other end, in all his actions, than private interest. By this interest we must govern him and, by means of it, make him, notwithstanding his insatiable avarice and ambition, co-operate to public good. Without this, say they, we shall in vain boast of the advantages of any constitution and shall find in the end that we have no security for our liberties or possessions except the goodwill of our rulers; that is we shall have no security at all.
>
> It is therefore, a just political maxim that every man must be supposed a knave, though at the same time it appears somewhat strange that a maxim should be true in politics which is false in fact. But to satisfy us on this head we may consider that men are generally more honest in their private than their public capacity, and will go greater lengths to serve a party than when their own private interest is alone concerned.
>
> To which we may add that every court or senate is determined by the greater number of voices, so that, if self-interest influences only the majority (as it will always do), the whole senate follows the allurements of this separate interest and acts as if it contained not one member who had any regard to public interest and liberty. (Hendle (ed.) (1953), p. 68)

Hume as we shall see was prescient about the political economy of democratic welfare states.

III. GROWTH INEQUALITY AND POVERTY ALLEVIATION

A usual riposte to the classical liberal position of separating questions of alleviating absolute poverty from egalitarianism is that, in theory, a market-based growth process could lead to such a worsening of the income distribution, that instead of the poor seeing a rise in their incomes as part of the growth process, they could be immisserised. This view was strengthened by the so-called Kuznets hypothesis which stated that, inequality was likely to worsen in the early stages of development before it declined, with per capita incomes rising towards current developed country levels.

All the empirical evidence, to date, is against the Kuznets hypothesis, and its corollary that growth might not alleviate absolute mass poverty. In the Lal-Myint studies the country authors were asked to fix a poverty line at the nominal income of the lowest 20% of the income distribution in the base year 1950, and then to keep this absolute country specific poverty line constant over the period of study. They were then asked to form judgments on how the headcount index of poverty had moved during the subsequent 35 years, with the fluctuations in the growth rate of the economy. As no meaning can be attached to inter-country comparisons in the changes in the resulting headcounts, the only interest of the exercise is in the directional change in the index as growth rates rose or fell in each country. Table 1, summarizes the evidence from the country studies. From this it is evident that there is a clear positive effect of per capita income growth on poverty redressal, but not for reductions in income inequality (where the pattern is extremely mixed).

Further evidence on the positive association between poverty redressal and growth was provided in a special study by Fields (1991) which formed part of the Lal-Myint comparative study. He put together the available data on poverty redressal and inequality for all the developing countries for which it is available subject to some minimal criteria of consistency. His results on poverty and growth are summarized in Table 2. He found that it is true in most but not all cases that poverty tends to decrease with growth, and that poverty tends to decrease most the more rapid is economic growth. Second, he finds that growth has not had a demonstrably greater effect in reducing poverty in Asia than in Latin America, but rather the available evidence supports the opposite conclusion.[8]

TABLE 1

Growth, Poverty and Inequality

			GDP per Capita Growth Rate %	Poverty	Income Inequality
(I)	GDP Per Capita Positive Growth				
	Labor Abundant				
	Hong Kong		6.6	↓	↓↑
	Singapore		6.5	↓	↓↑
	Malta		5.2	↓	↓
	Land Abundant				
	Malaysia		4.3	↓	↑↓
	Thailand		4.0	↓	↓
	Brazil		3.9	↓	↑
	Turkey		3.1	↓	↓
	Mexico		2.6	↓	↑
	Costa Rica		1.8	↓	↓
	Colombia		2.1	↓	↓
	Intermediate				
	Egypt		3.0	↓	n.c.
	Indonesia		3.1	↓	↓
	Sri Lanka		2.6	↓ 53-70	↓ 53-69
				↑ 70-77	↑ 70-77
				↑ 77-	↓ 77-
	Malawi		1.5	↑ 64-84	↑
	Mauritius		0.7	n.a.	n.a.

			GDP per Capita Growth Rate %	Poverty	Income Inequality
(II)	Mixed Performance of GDP Per Capita Growth				
	Land Abundant				
	Uruguay	↓ 1955-67	-1		?
		↑ 1967-85 (67-84)	1.2	n.c.	↑
	Nigeria	↑ 1960-73	3.4	↓ n.c.	↑
		↑ 1973-79	0.6	n.c.	↑
		↓ 1979-84	-5.9	↑	↑
	Intermediate				
	Peru	↑ 1950-81	2.1	n.c.	↑
		↓ 1981-85	-3.9		
	Jamaica	↑ 1950-72	4.7	↓	↑
		↓ 1972-86	-2.9	↑	↑
	Madagascar	↑ 1950-69	1.0	↑	↑
		↓ 1969-84	-2.2	↑	↑

			GDP per Capita Growth Rate %	Poverty	Income Inequality
(III)	Falling GDP Per Capita				
	Ghana	1960-81	-1.0	↑	↑

Table 1 (cont.)

n.c. = no change

Poverty and Income Inequality trends are taken from the country studies.

Source: (I) GDP per capita growth rates are taken from Table 2.1, Col. 3.
(II) GDP per capita growth rates are calculated from country study data and in the case of Nigeria and Ghana from World Bank data files.

TABLE 2

Change in Poverty and Rates of Growth,

Spell Analysis

Spell		Growth Rate of GNP	Change in Poverty
		A. Change in Poverty and Growth Rate of GNP	
Jamaica	1973-1979	-4.3%	Poverty increased*
Bangladesh	1966/67-1973/74	-2.1	Mixed evidence*
Pakistan	1969/70-1979	1.7	Poverty decreased
Sri Lanka	1963-1973	2.2	Poverty decreased*
Bangladesh	1976/77-1981/82	2.4	Mixed evidence*
Sri Lanka	1978/79-1981/82	2.8	Mixed evidence*
Sri Lanka	1973-1978/79	3.3	Poverty decreased
Korea	1976-1980	3.5	Poverty decreased
Thailand	1968/69-1975/76	4.0	Poverty decreased
Thailand	1975/76-1981	4.1	Poverty decreased
Mexico	1963-68	4.3	Poverty decreased
Indonesia	1978-1980	4.5	Poverty decreased
Bangladesh	1973/74-1976/77	4.8	Poverty increased
Indonesia	1970-1976	4.8	Poverty decreased
Jamaica	1968-73	4.9	Poverty Increased
Indonesia	1976-1978	4.9	Poverty decreased
Malaysia	1976-1979	4.9	Poverty decreased
Malaysia	1970-1976	5.0	Poverty decreased
Thailand	1962/63-1968/69	5.2	Poverty decreased
Hong Kong	1966-1971	5.4	Poverty decreased
Singapore	1975-1980	5.8	Poverty decreased
Hong Kong	1971-1976	7.3	Poverty decreased
Korea	1965-1970	7.6	Poverty decreased
Korea	1970-1976	7.8	Poverty decreased
Singapore	1966-1975	8.8	Poverty decreased
		B. Change in Poverty and Growth Rate of ICP	
Jamaica	1973-1979	-3.5%	Poverty increased
Sri Lanka	1963-1973	-2.1	Poverty decreased*
Bangladesh	1966/67-1973/74	-0.7	Mixed evidence*
Pakistan	1969/70-1979	1.5	Poverty decreased
Bangladesh	1973/74-1976/77	2.6	Poverty increased
Jamaica	1968-1973	3.0	Poverty increased
Sri Lanka	1973-1978/79	3.3	Poverty decreased
Thailand	1968/69-1975/76	3.5	Poverty decreased
Mexico	1963-1968	4.5	Poverty decreased
Malaysia	1970-1976	4.6	Poverty decreased
Thailand	1962/63-1968/69	5.3	Poverty decreased
Hong Kong	1966-1971	5.9	Poverty decreased

Table 2 (cont.)

Spell		Growth Rate of GNP	Change in Poverty
Indonesia	1970-1976	6.0	Poverty decreased
Singapore	1975-1980	6.3	Poverty decreased
Indonesia	1976-1978	6.5	Poverty decreased
Korea	1970-1976	6.6	Poverty decreased
Hong Kong	1971-1976	6.7	Poverty decreased
Indonesia	1978-1980	7.2	Poverty decreased
Korea	1965-1970	8.6	Poverty decreased
Singapore	1966-1975	8.8	Poverty decreased
Malaysia	1976-1979	9.7	Poverty decreased

*Poverty increased using one poverty line and decreased using another.

Sources: For change in poverty - Table 2 in fields, op. cit.
Fields, Table 8, SPECSTUD
For growth rates of GNP - Calculated by the author from data in IMF Financial Statistics Supplement #8, pp. 18-21.
For growth rates of ICP - Calculated by the author from data in Summers and Heston (1984).

On inequality he finds that, first, there is no systematic tendency for inequality to increase with economic growth. In the available sample, inequality increased in as many growth episodes as it decreased. However, growth tends to increase inequality more often in Latin America than in Asia. Second, he finds no relationship between inequality in the initial distribution of income and subsequent growth rates. Nor does more rapid growth increase inequality -rather the converse seems to hold. Third, he concludes that there is no tendency for inequality to increase in the early than the later stages of development -- this refutes the Kuznets hypothesis.

Finally, Squire (1993) reports on a 21 country study for which comparable data on income distribution were available for two points of time. Using a headcount index based on a common poverty line in 1985 PPP dollars of $370 per person a year, an OLS regression of the change in the head count index (CHHI), and the growth in mean expenditure (G), and the initial head count index (HI), yielded:

$$\underset{(t = -4.06)}{CHHI = -0.24G} \quad \underset{(t = -2.90)}{- 0.01HI} \qquad \text{Adj Rsq.} = 0.70 \quad N=21$$

A one percent increase in the growth rate of mean income increases the annual rate of decline in the headcount index by 0.24 percentage points. Also, the negative sign on HI refutes the Kuznets hypothesis. "At least for this sample it appears that changes in inequality worked on average in favor of the poor ... and that this effect was stronger in situations where poverty was greater at the start of the period of observation" (Squire, p. 378).

The distributivist fears that the classical liberal presumption that growth would alleviate poverty would be vitiated by Kuznets curve-type processes turns out to be unfounded. On the existing evidence mass poverty can be alleviated by concentrating on the rapid efficient (labor intensive) growth promoted by a market economy, and we need not worry about the distributional consequences.

IV. WELFARE STATES FOR THE THIRD WORLD?

This still leaves problems of destitution and conjunctural poverty which are likely to exist even if growth takes account of the alleviation of mass poverty. Unlike the classical liberals who (as we saw in Section II) advocate targeted benefits to provide merit goods to these "deserving poor", the socialist distributivist panacea is to institute Western style welfare states with the universalization of benefits, to deal with problems like insufficient take-up, and the costs of gathering information to identify beneficiaries (particularly in poor countries with weak administrative systems) which bedevil the targeting of benefits (see Atkinson (1987), Glewwe and van der Gaag (1988).

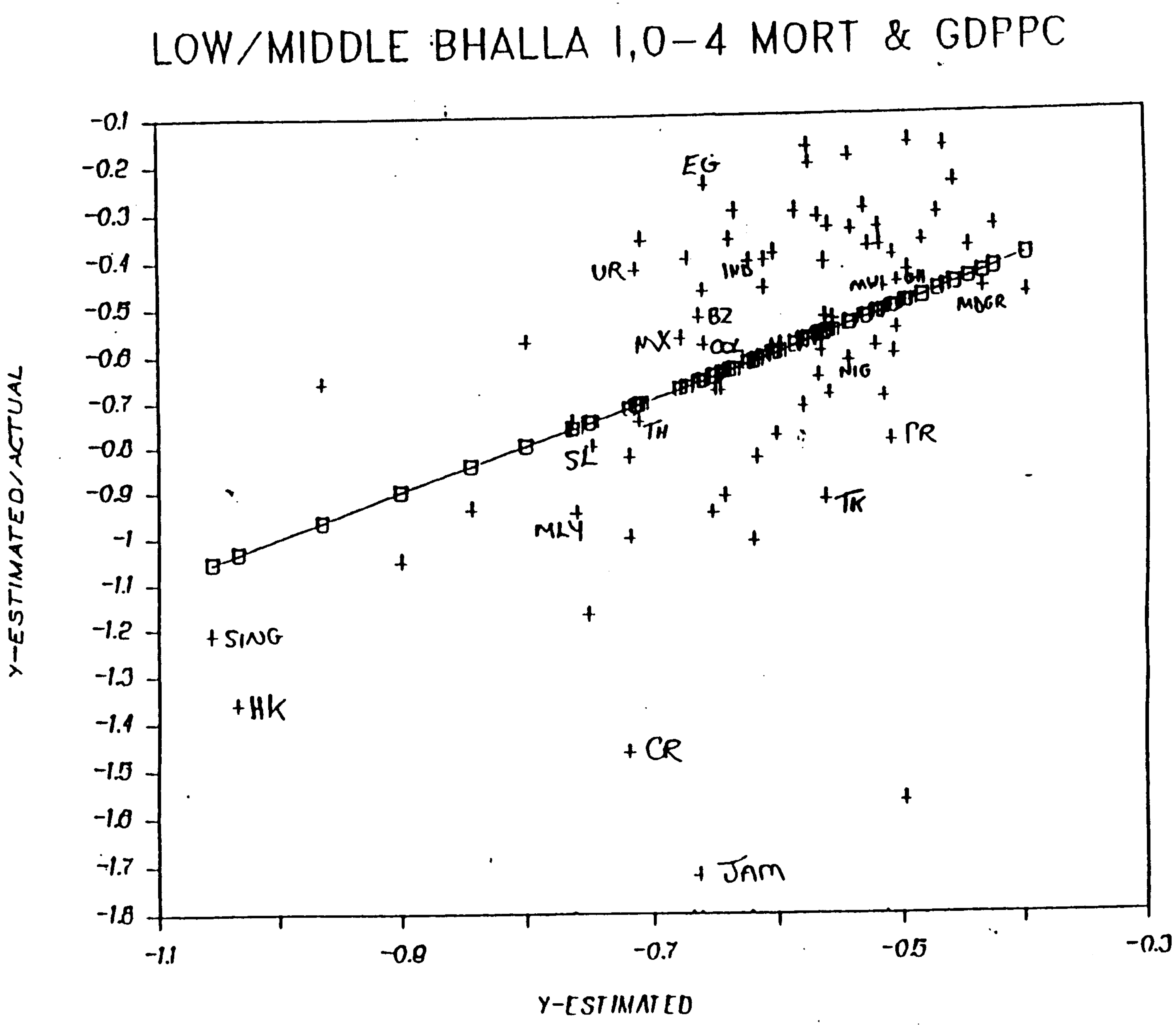
But it has also been argued that this so called "direct route" should also be used to deal with what we have labelled structural mass poverty. In an influential paper Sen (1981) had argued that a number of countries (e.g., Sri Lanka, Costa Rica) had succeeded in alleviating poverty despite low growth and beyond what could be expected with comparators with similar per capita income levels. Bhalla and Glewwe (1986), Bhalla (1988) have contested the inferences drawn by Sen from his empirics, essentially on the grounds that Sri Lanka had already achieved high levels of poverty alleviation (based on various social indicators), before Independence. Its post-independence record they argue was worse on both the growth and poverty alleviation indices if this historical adjustment for its social indicators was made. The subsequent debate has shed more heat than light (see Sen's response and Bhalla's riposte in Bardhan and Srinvisan (1988).

Cross-Sectional Evidence

As part of the Lal-Myint study we followed Bhalla in estimating a simple cross-sectional statistical model for three social indicators (the infant mortality rate, life expectancy, and the physical quality of life index (PQLI) due to Morrris (1979)), which allows the performance of our sample of countries to be judged relative to each country's own initial conditions (with respect to each indicator) as well as that of countries at similar levels of development or per capita income (at the base date) (see Bhalla (1988) for details of the model).

The model was estimated for the period 1960-86 for the three indicators. Two different sets of comparators were used. In one, countries in the same broad income class low income, middle income, high income, as defined by the World Bank were used. In the other all developing countries were taken as the relevant comparators. The results were not very different for the two sets of comparators. Figs. 1-3, show the results when the comparator was "all developing countries". Each figure shows the regression line for the relationship between the social indicator and per capita GDP growth rates for all developing countries. The countries in our sample are identified by self-explanatory symbols. If a country lies above (below) the line then its performance is worse (better) than its comparators. In Fig.1, which charts the child (0-4years) mortality regression, Egypt, Indonesia, Uruguay and Mexico's performance is below par, whilst that of Singapore, Hong Kong, Malaysia, Costa Rica, Jamaica, Turkey and Peru is better than expected. In Fig.2, for life-expectancy, Uruguay, Malawi, Brazil and Singapore's performance is worse than expected, whilst that of Hong Kong, Costa Rica, Jamaica, Malaysia, Egypt, Turkey, Indonesia and Madagascar is better than expected. Finally, in Fig 3 for the reduction in the composite

FIGURE 1


LOW/MIDDLE BHALLA 1,0–4 MORT & GDPPC
Y–ESTIMATED/ACTUAL
Y–ESTIMATED
-0.1
-0.2
-0.3
-0.4
-0.5
-0.6
-0.7
-0.8
-0.9
-1
-1.1
-1.2
-1.3
-1.4
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-1.6
-1.7
-1.8
-1.1
-0.9
-0.7
-0.5
-0.3
EG
UR
IND
BZ
MX
COL
MUL
GM
MDGR
NIG
TH
SL
PR
TK
MLY
SING
HK
CR
JAM

FIGURE 2

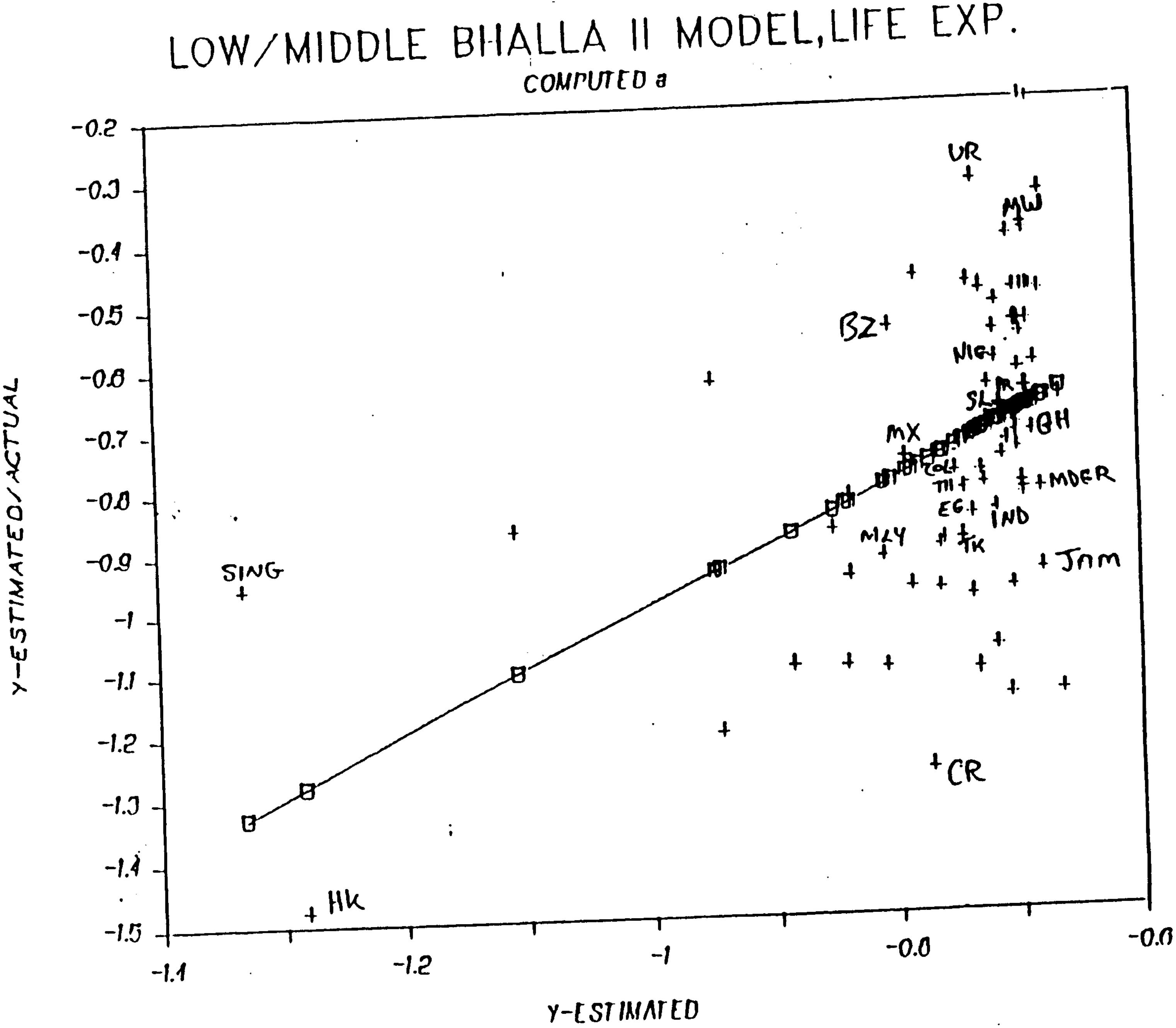
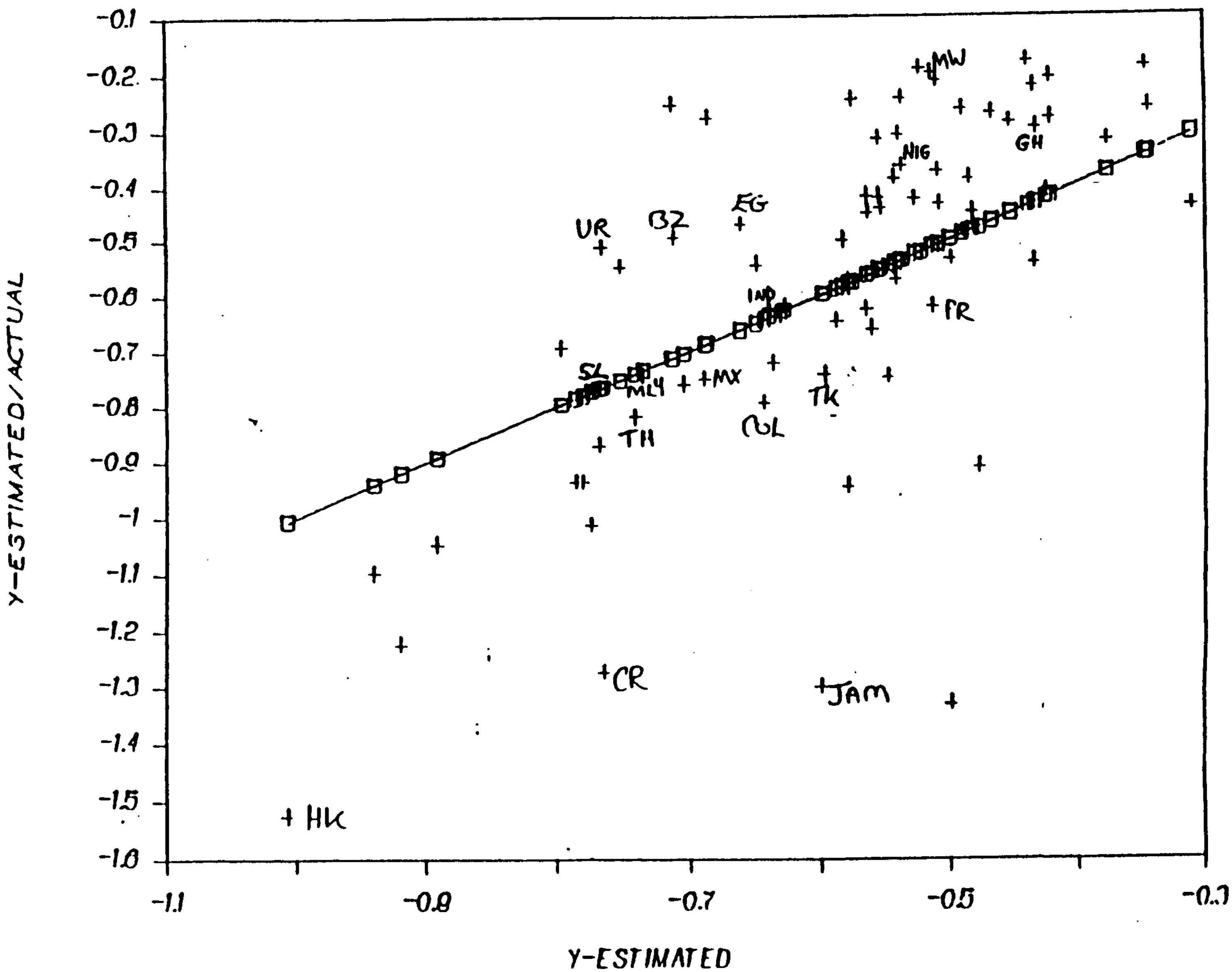

LOW/MIDDLE BHALLA II MODEL,LIFE EXP.
COMPUTED a
Y-ESTIMATED/ACTUAL
Y-ESTIMATED
-0.2
-0.3
-0.4
-0.5
-0.6
-0.7
-0.8
-0.9
-1
-1.1
-1.2
-1.3
-1.4
-1.5
-1.4
-1.2
-1
-0.8
-0.6
UR
MW
BZ
NIG
SL
MX
BH
MDER
IND
MLY
TK
Jam
SING
CR
HK

FIGURE 3

ALL LOW/MDDLE DR(100-PQLI) & GDPPC. BH1



PQLI deficit (from a notional value of 100), Uruguay, Brazil, Egypt, Nigeria, Malawi and Ghana's performance was distinctly worse, whilst that of Hong Kong, Costa Rica and Jamaica is very much better, as is possibly that of Thailand, Colombia, Turkey and Peru.

Taking all three figures together, it appears that Jamaica, Costa Rica, Turkey and Hong Kong do better than expected on these social indicators and Uruguay and Brazil worse. As the two ostensible welfare states in our sample -- Uruguay and Costa Rica -- fall on either side of the dividing line, as do two of the relatively "capitalist" economies -- Brazil and Hong Kong -- it is apparent that the type of support such cross-sectional regression analyses can provide to those who believe that poverty redressal requires so-called 'direct' government intervention is virtually non-existent.

Evidence From Analytical Economic Histories

The Lal-Myint comparative study therefore placed more weight on the long run analytical histories of the interactions between growth, poverty alleviation and the political economy of policy interventions in determining the qualitative conclusions about the relative productivity of the direct and indirect routes to poverty alleviation (see Bhagwati (1988)). For as is obvious, arguing as some proponents of the establishment of welfare states in the Third World have done, that low growth countries with direct poverty redressal programs have been successful in alleviating poverty, begs a number of important questions. The first is whether the direct interventions lowered growth rates (which would have had a deleterious effect on poverty redressal). The second is whether the resulting welfare entitlements which alleviated poverty were sustainable in a low growth environment.

Four of the countries in the Lal-Myint sample attempted to alleviate poverty through the creation of politically determined entitlements -- Sri

Lanka, Jamaica, Uruguay, Costa Rica.

The oldest and most notable example is that of Uruguay. It established a Western-style welfare state at the beginning of the century. It was financed by the rents from the main export crop -- meat. The main beneficiaries were the growing urban population (with more than half of the country's population being concentrated in the Montevedio metropolitan region). With the passing of political power from rural caudillos to a two-party system of government, the interests of these urban voters came to dominate the polity. They demanded and got the taxation of the export sector for their benefit. This was accompanied by import substitution policies in favor of urban manufacturing industries in response to powerful trade union pressure. The net effect of the welfare system and of the system of protection was to distort the relative prices of labor and capital, raising the former and lowering the latter (see Rottenberg et al. (1993)). This and the growing tax burden on the export sector led to a prolonged growth collapse, with GDP growth of less than 1% p.a. during 1955-73.

Equally serious were the fiscal consequences. As Favaro and Benison (in Rottenberg et al.) note, the tax resources available from a stagnating economy were unable to finance an explosive increase in welfare expenditures, due to demographic trends related to the ageing of the population, and the increased coverage of retirement benefits. Furthermore, the social security system came to be unfunded, as its reserves, which had been used to purchase public debt (itself issued to finance fiscal imbalances), were virtually wiped out by inflation. The fiscal crisis of the Uruguayan state which was in part responsible for its growth collapse was thus largely due to these unsustainable social expenditures. Thus the poor growth record of Uruguay (only partially reversed with the partial economic reforms undertaken since 1973) can in part be blamed on the redistributive "immobilisme" and inefficiencies that the combination of its welfare state and dirigiste trade and anti-agricultural policies entailed.

Costa Rica's development of a welfare state and its likely denouement seems to follow Uruguay's closely by about three decades. Beginning in the late 1930s and early 1940s, by the late 1970s the welfare system had been expanded to provide virtually universal social security. However Gonzales-Vega and Cespedes (in Rotenberg et al. (1993)) emphasize that most of the favorable poverty alleviation and equity outcomes were in place by the late 1960s. As in Uruguay the expanding welfare state was financed by taxing the rural export sector in favor of the politically dominant urban sector. Import substitution under the aegis of the Central American Common Market (CACM), initially raised the growth rate because of the "trade diversion" effects of the customs union. With the disintegration of the CACM in the welter of regional wars in Central America and the first oil shock, Costa Rica's situation rapidly deteriorated. Her government budget and balance of payments came under increasing strain under the twin burdens of financing inefficient public enterprises and increasing welfare expenditures and subsidies. GDP growth dropped to 2.9 % p.a. barely above population growth, and when coffee prices fell in 1978 Costa Rica fell over the brink into an economic collapse and debt crisis.

The poverty alleviation that occurred in Costa Rica was in place according to Gonzalez Vega and Cespedes by the late 1960s. It was due first to a rapid modern sector enlargement, and secondly to a rapid rise in agricultural productivity promoted by infrastructure investments in the 1960s -- which helped to alleviate poverty in the rural area (where poverty was concentrated). "Poverty declined from about 50% of the population around 1961 to somewhere between 20 and 25% in the mid 1970s" (Gonzalez-Vega and Cespedes). The welfare state was greatly expanded in the 1960s but it only became universal with its consolidation and universalization in the mid 1970s after the declines in poverty had taken place. As Gonzales Vega and Cespedes note:

> Increased income equality and poverty alleviation were the result, for most of the period, of growth itself and of improvements of the labor market. Only after the mid 1970s did explicit redistribution policies play a major role in explaining equity outcomes. The impact of these policies, however, was mixed ... when external events reduced the country's purchasing power, excessive entitlements and less than optimum policies contributed to retarded growth. (p. 238)

During the economic crisis in the 1980s poverty increased to about 30% of the population.

In both the Uruguayan and Costa Rican cases therefore whilst there was undoubtedly some poverty alleviation as a result of the expansion of their welfare states, over the long run the entitlements they created damaged the growth performance of the country, on which they were predicated, and hence eventually became unsustainable.

Virtually the same story can be told about the expansion of unviable social expenditures in Sri Lanka and Jamaica, financed by taxing growth-promoting productive activities, which have killed the goose that laid the golden egg. In both cases the improvements in poverty indices has not been sustainable.

The Political Economy of the Direct and Indirect Routes

The essential point which the Lal-Myint country studies emphasize can be brought out by noting Sen (1981)s statement (p. 309) that: "ultimately poverty removal must come to grips with the issue of entitlement guarantees"; and that whereas the 'growth' or 'indirect' route relies on "successfully fostered growth and the dynamism of the encouraged labor markets" the other dirigiste route "gives the government a more direct role as the provider of provisions". But as these country studies show there are important differences in the nature of the guarantee provided by each of these alternative ways of alleviating poverty. Not all guarantees are equally iron clad! The security of politically determined entitlements of the poor (in for instance our four welfare states) has come increasingly into question as the inexorable increase in their costs confronts a fixed economic pie from which they can be financed (in part resulting from the economic stagnation that such transfers have indirectly fostered). By contrast, the poverty in many of our higher growth countries (Hong Kong, Thailand, Indonesia, for instance) which has been alleviated through the rising incomes of the poor cannot be so readily reversed by political fiat. For these entitlements are really not underwritten by the State, but represent the higher returns on agents endowments. They have been underwritten by the wealth created in the growth process.

Thus, growth is the only certain means of alleviating mass poverty. The so-called "direct route" does not really offer a sustainable alternative, and by damaging growth performance could instead perpetuate mass poverty.

If the welfare state is an uncertain instrument, at best, for sustainable mass poverty alleviation, its interactions with a democratic polity is likely to turn it (when used to deal with the more limited problems of destitution and conjunctural poverty) into a transfer state, which following "Directors Law" (see Stigler (1970) is likely to be captured by the middles class (see Lal (1992) for a discussion and references to the literature). Besides posing a threat to the survival of the market economy because of the politicization of economic life it entails, it also leads to a deep corruption of the polity and society, as politicians vie with each other to buy votes with other people's money, and create a "dependency culture". As usual that farsighted and greatest of social scientists, De Tocqueville, saw this with clarity in his little known reflections on the emerging welfare state in the U.K. In his Memoir on Pauperism, he concluded:

> I am deeply convinced that any permanent, regular, administrative system whose aim will be to provide for the needs of the poor, will breed more miseries than it can cure, will deprave the population that it wants to help and comfort, will in time reduce the rich to being no more than the tenant-farmers of the poor, will dry up the sources of savings, will stop the accumulation of capital, will retard the development of trade, will benumb human industry and activity, and will culminate by bringing about a violent revolution in the State, when the number of those who receive alms will have become as great as those who give it, and the indigent, no longer being able to take from the impoverished rich the means of providing for his needs, will find it easier to plunder them of all their property at one stroke than to ask for their help. (Drescher (ed.) (1968) pp. 24-25)

The major qualification, resulting from the actual operations of majoritarian democracies that De Tocqueville did not foresee results from the replacement of but one word in the above, instead of "indigent" we now need to substitute "middle class"!

As Stigler (1970), and Meltzer and Richards (1981), have shown, in a majoritarian democracy where the median voter is decisive, the redistributive pressures for a "welfare state" will exist as long as the median income is below the mean, and with income being redistributed towards median income earners. However, because of the deadweight costs of taxation, it will not be in the interest of the decisive median voter to expropriate all incomes above the median, as that would also lower total income. One implication of this theory is that, with economic development, the thrust towards redistribution ends when the median voter's income moves towards the mean. A conclusion at variance with even the most casual historical evidence.

A richer model by Peltzman (1980) repairs this lacunae. It uses a variant of the pressure group model of Becker (1983), and hence is also applicable to polities which are not majoritarian democracies. The major empirical implications of Peltzman's model are that public transfers: (a) will increase if there is greater income equality within the beneficiary group; (b) will decrease if the potential beneficiaries' incomes increase relative to those of taxpayers; (c) will increase if there is an increase in the "ability" of the two groups to recognize their interests. The greater this ability amongst the beneficiary group, the more likely that the redistributive benefits will accrue to the poor. Peltzman fitted this model to a sample of developing countries and found it provided a satisfactory fit to the notoriously imperfect proxies used for the theoretical variables. We ran a similar regression for 17 of our countries for which we had data in the Lal-Myint study, and again found some support for the Peltzman model. This suggests that once the interactions of the polity and economy are taken into account, the consequences in terms of the size of the transfer state as well as the extent of poverty alleviation they engender may be very different from those predicted by purely technocratic analyses.

More serious are the effects of the welfare state on what De Tocqueville called, in his Democracy in America "the habits of the heart" -- the cultural underpinnings for both a democratic society and the market economy. The most sustained though controversial critique of the decadence in private habits engendered by the transfer state is in Murray (1984)'s examination of the results of the U.S. war on poverty. The cultural consequences of the welfare state maybe as momentous as the economic or political ones. But this is a very large subject beyond the scope of this paper.[9]

For our purpose we need only note the irony in the fact that at a time when the welfare state is coming under great stress because of its "internal contradictions" in the West (see Lal (1992) for references) -- which are very similar to the reasons why the Third World welfare states discussed above have become unviable (see Lal and Wolf (1986)) -- international institutions such as UNICEF and WIDER are seeking to promote their extension in the Third World. Rather than seeking ways to strengthen traditional methods of dealing with destitution and conjunctural poverty, and finding new ways of fostering the civic virtues and the growth of civil associations, on which (for the classical liberal) the health of sustainable democracies as well as market economies depends, a vast expansion of universal State provision for major components of expenditure is being sought. This is not likely to serve the cause of the market or of democracy in the Third World.

For as sociologists such as Robert Nisbet (in his <u>The Quest for Community</u>) have noted, the conversion of welfare into transfer states in the West, and their inevitable universalization under the pressure of democratic politics has led to an attack on civil society both from above and below.[10] From above the intermediate institutions of civil society are forced to surrender their functions and authority to professional elites and the bureaucracies of centralizing States. From below,"rights-chatter" -- the clamor for numerous and newly discovered individual rights- undermines the authority of those traditional civil institutions -- family, church, school, neighborhood -- which in the past promoted both private benevolence and the lower order "vigorous virtues". The acceptance of claims to various welfare rights, substitutes public for private benevolence -- sapping the latter, which for classical liberals is the highest (though scarce) virtue. It is these longer run, unintended, social (and fiscal) consequences of the Welfare state, which are now leading to its questioning and in some cases partial dismantling in the West -- the most dramatic example of the latter being the virtual abandonment of the New Zealand welfare state by its chastened socialist party!

But the problem of dealing with destitution and conjunctural poverty remains. As discussed in Lal (1992) there are no ideal solutions. Through the targeting of benefits, with the State involved in their finance but rarely in their provision, and with the decentralization of the administration and monitoring of the benefit system preferably to various non-governmental civil associations, much could still be achieved. But this would mean that Chile, not Sri Lanka, or Uruguay, or Costa Rica or Jamaica, would (on the basis of experience) be the relevant "model" for promoting both growth and poverty alleviation. An intellectual consensus on this is prevented by the continuing adherence of most of the Western "chattering classes" to the notion of the State as an enterprise association which they would like to use to promote their socialist ideal of some form of egalitarianism. Hopefully, however, socialists who in the past have worshipped the God of History, will learn its lessons. They will come to realize that, not only the communist command economy, but also the social democratic welfare state are gods that failed!

NOTES

[1]The studies in the series entitled "The Political Economy of Poverty Equity and Growth." edited by D. Lal and H. Myint, and published for the World Bank by OUP, New York are: Malawi and Madagascar (Pryor, 1990); Egypt and Turkey (Hansen, 1991); Sri Lanka and Malaysia (Bruton, 1992); Brazil and Mexico (Maddison et al., 1992); Costa Rica and Uruguay (Rottenberg et al., 1993); five small economies -- Hong Kong, Singapore, Malta, Jamaica and Mauritius (Findlay and Wellisz, 1993); Indonesia and Nigeria (Bevan, Collier and Gunning, in press, 1993). In addition a study of Ghana (Rimmer, in press, 1993) is to be published by Pergamon press and of Thailand (Meesook et al., forthcoming) by the World Bank. The study of Colombia and Peru (Urdinola, Serrano and Webb, 1990) is available in mimeo form from the Bank's Latin American department. A collection of specially commissioned essays on cross-country themes was published by Pergamon (Pscharopolous, 1991). Finally the synthesis volume of the comparative study is being published by the Clarendon Press, Oxford (Lal-Myint, in press).

[2]But see Sen (1976), Kakwani (1980), Ravallion (1992). The serious data problems in making intercountry comparisons of changes in living standards should also be noted. In an overview of the findings of a conference on the data base for development analysis, Srinivasan recently concluded: "the situation with respect to the quality, coverage, intertemporal and international comparability of published data on vital aspects of the development process is still abysmal in spite of decades of efforts at improvements". He is particularly critical of the spurious sense of "reliability, comprehensiveness and comparability" created by the data

published by various international agencies, which rarely point out the serious deficiencies in their reported numbers. Thus he notes:

> seven out of 180 less developed countries have not held a population census as yet and for 22 the date of the most recent census is prior to 1975. Relatively reliable and recent ... [later than 1980] data for estimating life expectancy at birth (infant mortality) are not available for as many as 87(65) out of 117 less developed countries. ... Given this issue it is nothing short of scandalous that the much touted Human Development Report of the UNDP not only does not inform its readers that the trends in life expectancy and the Human Development Index are based on guesses for countries for which no reliable data exist and dubious projections for countries for which the most recent data on life expectancy goes back to 1979 or earlier.

Nor are the published national income and GDP growth rate figures any better. Thus he notes:

> According to the World Bank's "World Development Indicators" 1992, Table 1, in 1990 India and China had GNP per capita of U.S. $350 and U.S. $370 respectively and the average annual growth rate of GNP per capita during 1965-90 was 1.9% in India and 5.5% in China. Taken together these levels and rates of growth would imply that China's per capita GNP was about 40% of India's in 1965! No knowledgeable observer of the two countries would subscribe to this ranking.

Given these serious statistical problems the Lal-Myint study was designed to rely on in depth historical country studies as the basis for the cross-country inferences that were made, rather than the type of statistical cross-sectional studies which have recently proliferated in the development literature. Apart from the serious problems concerning the non-robustness of the estimated regressions (see Levine & Renelt (1992)), and the absurdity of giving an "observation" say Chad, the same weight as India or China, the fragility of the underlying data sets that are used makes most of this work unpersuasive.

[3]As Himmelfarb (1983) notes:

> ... "ye have the poor always with you". That thought came echoing down through the centuries with the authority of Scripture and the practical wisdom of the ages. And with it came a complicated-

> ambivalent, we would now think of it-conception of poverty, which made it at the same time a blessing to be devoutly sought and a misfortune to be piously endured. ... Those who were blessed not with poverty but with riches had the sacred duty of charity, the obligation to sustain the holy poor and to relieve the misery of the unholy. With every aspect of poverty and charity penetrated by religious meaning, the church inevitably became the instrument both of social amelioration and of spiritual salvation; indeed the one was the function of the other. (pp. 3-4)

[4]The "World Development Report 1990" estimated that of the 1,116 million in poverty worldwide (i.e., with a per capita consumption of less than U.S. $370 in 1985PPP) 700 million were accounted for by South Asia and sub-saharan Africa. Of the 633 million globally in extreme poverty (per capita consumption of less than $275) an even higher proportion (520 million) were in these two regions. For South Asia, particularly in India, the major cause of continuing mass structural poverty is a low growth rate, which in turn has been caused by its dirigiste policies (see Lal (1989)). Whilst in Africa its continuing endemic structural poverty is due to the neglect of the rural countryside (see Collier and Lal (1986)). As Ilife summarizing the evidence on the causes of African structural poverty concludes, it was the progressive deterioration of the rural-urban terms of trade which led to "the steady drainage of cash from the countryside [and] was the continent's main cause of poverty". This in turn was due to the well-known urban bias of African development policy " which bred unprofitable enterprises, heavy recurrent costs, unpayable debts and exploited villagers".

[5]Himmelfarb notes that by the end of the 18th century the distinction between the indigent and the poor had become clearly established, and cites a succinct formulation by Patrick Colloquhon in 1799:

> Indigence therefore, and not poverty, is the evil. It is that condition in society which implies want, misery, and distress. It

> is the state of anyone who is destitute of the means of subsistence, and is unable to labor or procure it to the extent nature requires. The natural source of subsistence is the labor of the individual; while that remains with him he is denominated poor; when it fails in whole or in part he becomes indigent.
> (cited in Himmelfarb (1983), p. 78)

[6]Increasing destitution has been due to political violence in post-colonial Africa, and not to the cyclical climatic factors which have always put some Africans (particularly pastoralists) at risk. The various civil wars in Africa have created 12 million "mass distress migrants" between 1964-84 (R. Olivier, review of Ilife, TLS, 27 May 1987).

[7]Some dirigistes have evoked Adam Smith to their cause by pointing to the so-called "Adam Smith problem", where the individualism underlying The Wealth of Nations is contrasted with the altruism extolled as the supreme virtue in his Theory of Moral Sentiments. It being claimed that Smith the moral philosopher seems to condemn the very society that Smith the economist commended. In an important book Muller (1992) has shown that there is no such incoherence in Smith's work. The above remarks on the Scottish Enlightenment's views on ethics and economics are based on this work.

[8]UNICEF (1984) and Jolly and Corvia (1984) have maintained that the various macroeconomic adjustment programs undertaken to repair the damage done by past dirigisme have damaged the prospects of the poor. Behrman (1991) examined this issue for the Lal-Myint study. He concluded:

> UNICEF and others have made strong claims about negative multiplier effects of macro-economic adjustment policies on health and nutrition. Careful examination of the relevant studies, however, suggests that the empirical basis for such a claim currently is weak. In fact the underlying studies seem to be characterized better as reflecting how well societies and people have adapted to minimize negative health and nutrition effects rather than the more negative interpretation given by UNICEF.
> (Behrman (1991))

[9]The Catholic social scientist Michael Novak has been one of the most trenchant observers of the moral corruption engendered by the welfare state. In a recent lecture (Novak (1993)) he notes that by ceding too much authority to the collective the welfare state saps the personal sense of responsibility. "We come to feel [by a multitude of rationalizations] that the state 'owes' us benefits, that we are as 'entitled' to them as anybody else, and that we would be foolish not to take what is so abundantly offered whether, strictly, we need it or not. The welfare state corrupts us all" (p. 5). He cites evidence from the Netherlands for instance where "about 15% of the potential workforce is collecting disability under a generous system that has granted workers a net 80% of their take-home salaries for life. ... One-third of the disability inflow is because of psychological problems. Another third is because of back- problems, which are sometimes questionable" (ibid. p. 14)!

[10]This is based on Joyce (1993).

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