Macroeconomics and Human Development

Edited by
Deepak Nayyar

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Macroeconomics and Human Development

In the conventional discourse on macroeconomics, the subject of human development is at best marginal and at worst irrelevant. In the unconventional discourse on human development, macroeconomics or its constraints are seldom recognised, even if its consequences are often highlighted. There are, however, intersections and interconnections, which provide the rationale for this book that seeks to map some broad contours of an unexplored, yet important, domain. Macroeconomics is important for human development because it determines levels of employment, the degree of social protection and the public provision of services such as healthcare or education. Human development has implications and consequences for macroeconomics, for it can mobilise or claim resources to enlarge or diminish space for macroeconomic policies. The relationship exists, and matters, not only in poor countries but also in rich countries. Employment, even if neglected, provides the critical link. This book shows that causation runs in both directions and can be either positive or negative. It reveals similarities and differences between developing countries and industrialised countries. The political context is significant everywhere as interests, ideology and institutions influence economic policies in both spheres to shape outcomes.

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Chapter 2
Macroeconomics and Human Development
Deepak Nayyar
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 7-30

Chapter 3
Macroeconomic Fluctuations, Inequality, and Human Development
Joseph E. Stiglitz
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 31-58

Chapter 4
Macroeconomics, Human Development, and Distribution
Stephanie Seguino
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 59-82

Chapter 5
The Impact of Global Economic Crises on the Poor: Comparing the 1980s and 2000s
Frances Stewart
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 83-106

Chapter 6
Economic Growth, Equity and Human Development in Latin America
José Antonio Ocampo and Juliana Vallejo
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 107-134

Chapter 7
Financial Globalization and Human Development
Ajit Singh
Journal of Human Development and Capabilities, volume 13, issue 1 (February 2012)
pp. 135-151

Notes on Contributors

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Contents

Citation Information vii
Notes on Contributors ix

1. On Macroeconomics and Human Development: An Unexplored Domain
Deepak Nayyar 1

2. Macroeconomics and Human Development
Deepak Nayyar 7

3. Macroeconomic Fluctuations, Inequality, and Human Development
Joseph E. Stiglitz 31

4. Macroeconomics, Human Development, and Distribution
Stephanie Seguino 59

5. The Impact of Global Economic Crises on the Poor: Comparing the 1980s and 2000s
Frances Stewart 83

6. Economic Growth, Equity and Human Development in Latin America
José Antonio Ocampo and Juliana Vallejo 107

7. Financial Globalization and Human Development
Ajit Singh 135

Index 153

On Macroeconomics and Human Development: An Unexplored Domain

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In the aftermath of the global economic crisis, macroeconomics is centre-stage once again, not only in the industrialized countries or emerging economies but also in poorer developing countries. The focus is on recovery, stability and growth in economies everywhere. For some time now, there has also been an increasing consciousness, if not a growing concern, about human development. The focus is on the well-being of people, ordinary people, but in the developing world alone. It would be reasonable for an economics undergraduate or a concerned citizen to believe that there is a relationship between the state of economies at a macro level and the living conditions of people at a micro level. Yet, a reading of the literature on the two subjects, macroeconomics and human development, suggests that these are two different worlds. The twain almost never meets. The discussion seldom intersects. The debates are separate. Even if this characterization is caricature, or an exaggeration, it does capture a virtual reality.

In the conventional discourse on macroeconomics, human development is at best marginal and at worst irrelevant. There are plausible reasons that cannot suffice as an explanation. For macroeconomics, whether theory or policy, the time horizon is the short run, whereas human development is about the long term. More important, perhaps, macroeconomic objectives, which no longer focus on full employment, are different in their concerns and do not address, let alone incorporate, any aspect of human development. Consequently, those concerned with macroeconomic policies neglect, or do not pay sufficient attention to, their implications and consequences for human development.

In the unconventional discourse on human development, macroeconomics or its constraints are seldom recognized, even if its consequences are often highlighted. Indeed, this literature is conspicuously silent on the concerns or dilemmas of macroeconomics. This may be attributable in part, but only in part, to different time horizons. The reason, perhaps, is a focus on the ends rather than means which is where the connection with macroeconomics lies. Hence, those engaged with human development, whether analysis or practice, either neglect or do not sufficiently recognize the implications and consequences for macroeconomics in terms of policies, constraints or space.

It would seem that the neglect of one by the other is almost symmetrical. There are, however, intersections and interconnections. It is also clear that the relationship between macroeconomics and human development is complex. And the causation runs in both directions. The world of macroeconomics has important implications and consequences for human development, which could be positive or negative. The quest for, or level of, human development has significant implications and consequences for macroeconomics, which could be positive or negative. Thus, it is both necessary and appropriate to analyse the interdependence between these two almost dichotomized worlds. This provides the rationale for the present book, which seeks to map some broad contours of an unexplored, yet important, domain.

The chapter by Nayyar provides an analytical overview of the relationship between macroeconomics, in terms of objectives and policies, and human development, which is about the well-being of people. It suggests that the intersection between macroeconomics and human development has diminished as the concerns of macroeconomics have become narrower while the conception of development has become wider with the passage of time. Even so, each can, and often does, exercise a significant influence on the other. Macroeconomics matters for human development because it determines the level of employment, the degree of social protection and the public provision of services such as healthcare or education. Human development has implications and consequences for macroeconomics, for it can mobilize or claim resources to enlarge or diminish space for macroeconomic policies. The relationship exists, and matters, not only in poor countries but also in rich countries. This reality is not quite recognized in the literature on the subject. Employment, even if neglected, provides the critical link in both sets of countries. The chapter shows that the causation runs in both directions and could be either positive or negative. It also reveals similarities and differences between developing countries and industrialized countries, which are worth noting and deserve more attention. The political context is significant, everywhere, as interests, ideology and institutions influence economic policies in both spheres to shape outcomes.

The chapter by Stiglitz examines the two-way relationship between economic inequality and economic fluctuations to consider the implications for human development. Its focus is on industrialized countries but the discussion also relates to developing countries. The author begins with the proposition that the dominant paradigm in macroeconomics, which assumed that income distribution did not matter, at least for macroeconomic behaviour, simply ignored inequality for a long time. Yet, inequality can drive fluctuations and cause crises, while fluctuations and crises both have an impact on inequality. But the most recent financial crisis has revealed the errors in this thinking, so that such views are finally beginning to be questioned. Until not so long ago, economists who had considered the average equity of a homeowner, ignoring the distribution, felt comforted in the belief that the economy could easily withstand a large fall in housing prices. However, when such a fall occurred in the crisis, it had disastrous consequences, because a large fraction of homeowners owed more on their homes than the value of the home, leading to waves of foreclosure and economic stress. Economists and policymakers alike have begun to take note: inequality can contribute to volatility and the creation of crises, while volatility can contribute to inequality. The chapter explores the variety of channels through which inequality affects fluctuations and fluctuations affect inequality, to explain how some changes in economies such as the United States contributed both directly and indirectly to increased inequality and volatility. Hysteresis means that the short-run consequences of an economic downturn can persist in the long term. The author goes on to discuss how policies can either mitigate or exacerbate the inequality consequences of economic downturns to show how well-intentioned policies can sometimes be counter-productive. These issues are then linked to human development, especially in developing countries.

The chapter by Seguino considers how human development concerns might be integrated into a macroeconomic framework, derived from Kalecki that already incorporates income-based equity concerns. It emerges that greater equality can either be a drag on, or a stimulus to, growth, depending on the type of inequality and macro-level policies regulating trade and investment. The challenge for governments is to develop mechanisms that promote broadly shared well-being, thereby reducing inequality without, however, sacrificing the overall objective of stimulating economic growth. Thus, macroeconomic policies designed to pursue an equity-led growth strategy must take into account the complexity of the feedback effects between economic growth and human development, because distribution itself influences macroeconomic outcomes. Under the right conditions, a more equitable distribution of income and opportunities in the form of human development can be a stimulus to growth, funding further investments in human development. Formulating the policies to create such conditions is the essential challenge for any macroeconomic framework that is conducive to human development. In pursuit of this objective, the author examines macroeconomic policies that could be more inclusive, identifying critical roles for fiscal policy with an emphasis on public investment in infrastructure to raise productivity and for monetary policy with an emphasis credit to priority sectors, instead of inflation targeting, to expand employment. The mix of policies suggested also extends beyond the sphere of macro policies.

The chapter by Stewart examines the impact of macroeconomic crises on poor countries and poor people, by comparing the financial crisis of 2008 with the debt crisis in the 1980s. It shows that the impact of the recent crisis was more widespread but its effects on different countries were more varied, as sources of external financing shaped outcomes. The worst affected regions were Southern Europe, Eastern Europe and Latin America. Sub-Saharan Africa was affected much less because countries in this region were heavily dependent on aid and not quite integrated with international financial markets. This provides a contrast with the 1980s when sub-Saharan Africa and Latin America suffered most. In aggregate terms, the contraction in gross domestic product (GDP) was much greater in the late 2000s than in the 1980s. Yet, on the whole, the impact on poverty was less. The significant difference was that countries had far more autonomy in policy response with a distinctly reduced dependence on the International Monetary Fund (IMF) during the late 2000s, in sharp contrast with the 1980s, which allowed most countries to follow counter-cyclical expansionary macroeconomic policies. Government expenditure as a proportion of GDP was generally sustained in the late 2000s as compared with severe cuts in the 1980s. Moreover, there were more extensive programmes of social support for the poor already in place in the late 2000s that provided some protection in the economic downturn. Unlike the 1980s, however, there is no concrete evidence on what happened to poverty following the crisis in 2008. Global estimates based on simulations show a slowdown in poverty reduction but no increase in actual poverty rates. But a review of available data by the author reveals an increase in the income poverty rate, even with the existing social protection in some countries, although the increase in poverty was modest as compared with the 1980s. Given the shorter duration of the crisis in the late 2000s so far, people and governments could draw on their savings to protect livelihoods, but if the recession persists longer the poverty consequences could be worse.

The chapter by Ocampo and Vallejo discusses the relationship between economic growth and equity in Latin America over the last two decades. It analyses the links that operate through the labour market, considers the evolution of poverty and income distribution, and shows the pattern of social spending with the resulting expansion of social services. It finds that the economy–equity relationship in Latin America reveals a story of marked contrasts. The highlight is the increases in public spending, possibly driven by political democracy, which are reflected in greater access to education, healthcare and public services with an associated progress in terms of human development. The shadows are the weak performance of the labour market and the limited strengthening or even weakening of social security. These two phenomena are connected, as access to social protection depends on formal employment. An intermediate situation characterizes poverty and income distribution, where there has been important progress during the first decade of the twenty-first century after almost a quarter-century of unsatisfactory performance. Even so, the region continues to maintain levels of inequality that are among the highest in the world. The authors conclude that this panorama can be described as a process of human development with precarious employment and economic insecurity, so that its effects on economic growth have not been positive or strong. It also suggests that Latin America has found it easier to respond to the challenge of human development than to the challenges of reducing inequality and creating employment.

The chapter by Singh examines the relationship between financial globalization and economic welfare, situated in the wider context of the political economy of financial liberalization, to consider its implications for human development. Orthodox theory suggests that there should be no welfare losses because financial liberalization allows for greater risk-sharing between countries, which should lead to a smoothening of consumption and growth trajectories in developing countries. Yet, there is widespread evidence of crises following such liberalization, which have dampened growth and accentuated volatility. This does adversely affect the poor. Even so, the author suggests that appropriate policy responses in developing countries could limit the negative consequences of financial liberalization and harness its positive consequences for national economies. It is further argued that such a macroeconomic perspective is essential but cannot suffice, because the globalization of finance has changed the very nature of capitalism from managerial capitalism to finance capitalism. This has consequences not only at the macro level but also at the meso and the micro levels. There are effects on corporate control, corporate governance and corporate finance. And there are implications for income distribution. The author concludes that both the macroeconomic factors and the microeconomic factors associated with national and international financial liberalization exercise an influence on human development.

The essays in this book provide a modest beginning in thinking about the relationship between macroeconomics and human development, which is a largely unexplored domain. In doing so, the discussion draws upon theory and experience. It also shows that the causation can be either positive or negative. It further suggests that, although the literature on human development tends to focus on poor countries and poor people, this relationship exists, and matters, even in rich countries. Taken together, the chapters in this book address questions that span a wide range. But the number of questions raised is limited by the scope of the chapters. There are unanswered questions. And there are unasked questions. It is hoped that this book will stimulate thinking and motivate research on the theme.

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Macroeconomics and Human Development

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Abstract This article analyses the interactions between macroeconomics, in terms of objectives and policies, and human development, which is about the well-being of people. Each can, and often does, exercise a significant influence on the other. Macroeconomics matters for human development because it determines the level of employment, the degree of social protection and the public provision of services such as healthcare or education. Human development has implications and consequences for macroeconomics, for it can mobilize or claim resources to enlarge or diminish space for macroeconomic policies. The relationship exists, and matters, not only in poor countries but also in rich countries. Employment, even if neglected, provides the critical link. The paper shows that the causation runs in both directions and could be either positive or negative. It also reveals similarities and differences between developing countries and industrialized countries. The political context is significant, everywhere, as interests, ideology and institutions influence economic policies in both spheres to shape outcomes.

Introduction

The object of this essay is to analyse the relationship between macroeconomics and human development. The interdependence and the interconnections between them are seldom explored in the literature in either domain. There is, of course, some literature on economic growth and human development. And economic growth is an important dimension of macroeconomics. There is also an extensive literature on income distribution and economic growth. And income distribution matters for human development. But this paper is about neither of those intersections. It seeks to examine the interactions between macroeconomics, in terms of objectives or policies, and human development, which is about the well-being of people. Each can, and often does, exercise a significant influence on the other. Hence, it is necessary to understand the nature and the direction of causation. At the same time, even if the focus of the literature on human development is almost entirely on the developing world, it is necessary to recognize that this relationship also exists, and could matter, in industrial societies. The similarities and differences between poor countries and rich countries, in this sphere, deserve more attention.

The structure of the discussion is as follows. The next section explains why the intersection between macroeconomics and human development has diminished over time, although there was some cognition about it in the past and there is an obvious interdependence in the present. The third section analyses the implications and consequences of macroeconomics for human development, which could be positive or negative, in both developing countries and industrialized countries. The fourth section examines the implications and consequences of the quest for, or attainment of, human development for macroeconomics, which could be positive or negative, and may differ across countries depending on the level of income or stage of development. The fifth section considers the significance of the political context, where ideology, institutions and interests exercise a strong influence on economic policies in both spheres to shape outcomes. The final section draws together some conclusions that emerge.

Diminishing intersections

The intersection between macroeconomics and human development has diminished significantly with the passage of time. The concerns of macroeconomics have become narrower, while the conception of development, in particular human development, has become wider.

Over the past three decades, the focus of macroeconomic policies, everywhere, has become narrower. In industrialized countries, the traditional objectives were internal balance and external balance.[1] Internal balance was defined as full employment and price stability that would be conducive to economic growth. External balance was defined as equilibrium in the balance of payments primarily with reference to the current account. The decline of Keynesianism and the rise of monetarism in the mid-1970s led to a profound change. The conception of internal balance came to be confined to price stability, so that full employment was no longer an integral part of the objective.[2] This was partly attributable to the belief that if the government achieves price stability, then the market will automatically achieve full employment. Since then, the notion of external balance has been progressively diluted in a world of capital account liberalization. In developing countries, the traditional concern was economic growth in the long term, subject to the constraints that inflation remained within limits of tolerance and that the current account deficit in the balance of payments remained within manageable proportions. The focus of policies shifted to macro-management in the short term after many developing countries, to begin with in Latin America during the early 1980s, and soon thereafter in sub-Saharan

Africa, ran into debt crises or other forms of macroeconomic disequilibrium. Again, the reason put forward was that if the government succeeded in achieving price stability in the short run, all else including growth would follow. The presumption that full employment and economic growth would materialize as corollaries was belied by experience in both industrialized and developing countries.[3]

Macroeconomics was developed in, and for, industrialized economies. Theory and policy were both concerned with how monetary and fiscal policies should be used to attain stipulated objectives. The narrow focus led to an apparent convergence of objectives. Hence, this corpus of knowledge was sought to be used in developing economies without any significant modification. Such transplantation was simply not appropriate for two reasons.[4] First, the nature of relationships (between variables) and the direction of causation (what determines what) in macroeconomics are both a function of the setting or the context. The starting point for any macroeconomic analysis is the distinction between exogenous and endogenous variables or that between autonomous and induced changes. Such a distinction is essential in macroeconomic theorizing, which seeks to analyse implications and prescribe policies. It is important to recognize that this distinction is derived not from the analytical structure but from the institutional setting of models.[5] Second, there are systematic differences in the structural characteristics of developing economies as compared with industrialized economies. These span a wide range from differences in the constraints on output expansion, the degree of wage – price flexibility, the sources of growth, the development of financial markets, institutions and instruments, or the capacity of governments to finance their deficits, to the ability to cope with shocks and crises.[6] There are also significant differences among developing countries. And even if some laws of economics are universal, the functioning of economies can be markedly different. Therefore, good economic theory and sensible policy analysis should recognize, rather than ignore such myriad differences. But orthodox thinking, which became dominant, simply ignored these differences.

Until the early 1980s, macroeconomic policies in developing countries were embedded in broader growth-oriented development strategies. These policies recognized the differences in structural characteristics of economies and incorporated a longer term perspective. But this approach changed for two reasons. First, macroeconomic instabilities and crises in developing countries surfaced and spread. Second, there was a shift from the Keynesian consensus on counter-cyclical demand management for full employment to the more conservative monetarist view that sought to control inflation. The control of inflation and the elimination of (internal and external) macroeconomic imbalances became the essential objectives. Orthodoxy stressed the importance of a stable macroeconomic environment. Macroeconomic policies sought to focus on stability, defined largely in terms of prices. Short-term stabilization, in a narrow sense, came to be seen as the path to long-term growth. This new orthodoxy prevailed as it was imposed on