Studies in Development Strategy and Systemic Transformation

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First published in Great Britain 2000 by
MACMILLAN PRESS LTD
Houndmills, Basingstoke, Hampshire RG21 6XS and London
Companies and representatives throughout the world

A catalogue record for this book is available from the British Library.

ISBN 0–333–80436–8

First published in the United States of America 2000 by
ST. MARTIN'S PRESS, INC.,
Scholarly and Reference Division,
175 Fifth Avenue, New York, N.Y. 10010

ISBN 0–312–23257–8

Library of Congress Cataloging-in-Publication Data
Griffin, Keith B.
Studies in development strategy and systemic transformation / Keith Griffin.
p. cm.
Includes index.
ISBN 0–312–23257–8 (cloth)
1. Economic development. I. Title.

HD75 .G74 2000
338.9—dc21

99–087198

10 9 8 7 6 5 4 3 2 1
09 08 07 06 05 04 03 02 01 00

Printed and bound in Great Britain by
Antony Rowe Ltd, Chippenham, Wiltshire

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To Benjamin, Chelsea and Isabel

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Preface

These *Studies in Development Strategy and Systemic Transformation* reflect my work in recent years. In 1994 I was invited to become a Member of the World Commission on Culture and Development and to help prepare a report, under the leadership of Javier Perez de Cuellar, that was published under the title of *Our Creative Diversity* (1995). I then advised the United Nations Educational, Scientific and Cultural Organization (UNESCO) on the preparation of its first *World Culture Report* (1998) and as part of that effort wrote a background paper that is published here as Chapter 2. In 1998 Macalester College in St Paul, Minnesota gave me an opportunity to assemble my thoughts on globalization when they invited me to present the keynote address at their International Round Table. The address is reprinted as Chapter 3.

The human development approach has been a major interest for many years. I have worked with the United Nations Development Programme (UNDP) on several occasions to help in the preparation of their annual *Human Development Report* and I have been sent to a number of countries by UNDP to help in applying the human development concept to practical policy issues. In 1999 Bob Sutcliffe invited me to present the keynote address at the tenth anniversary conference of the Institute for the Study of Development and the International Economy in Bilbao, Spain. The address is printed as Chapter 4. Chapter 5 contains a paper written with Amy Ickowitz which explores the relationship between the distribution of productive wealth and the pace of development. This was written originally at the request of Terry McKinley, then of UNDP, to stimulate thinking within UNDP about the relationships between human development, distributive issues and the elimination of poverty in low-income countries.

The collapse of communism and the attempts by ex-socialist countries to transform their economies by introducing a more market-oriented system are events of signal importance. I was fortunate, thanks to UNDP and the International Labour Organization (ILO), to have an opportunity to work on these issues. In Chapter 6 I discuss transition strategies at a general level, presenting a point of view that at first was controversial but is now more widely accepted. The paper originally was written as a background study for UNDP's *Regional Human Development Report for Central and Eastern Europe and the CIS Countries* (1999); it was also presented at a UNDP-sponsored conference, 'Central Asia, 2010' in Almaty, Kazakhstan in July 1998.

The three case studies are of transition economies. Chapter 9, on Vietnam, is based on work originally done for UNDP. The issue I was asked to explore was the link between macroeconomic and structural adjustment policies and the reduction of poverty. My paper on Kazakhstan, presented here as Chapter 10, was written for UNDP and the ILO. The issue there was how to design policies to provide social protection to the poor in a context of falling average incomes and severe transition difficulties. Chapter 11, on China, was written with Aziz Khan. This is a background paper written for UNDP as part of a joint World Bank/UNDP study of the effectiveness of China's poverty reduction strategy.

The hardships and disappointments experienced by sub-Saharan Africa, and the development strategies intended to remedy them, are the subject of two chapters. The first, Chapter 7, contains a critique of conventional stabilization and structural adjustment programmes as well as a proposal for an investment-led strategy of structural adjustment. It was writtten for the ILO in 1996. Chapter 8, with Mark Brenner, also written for the ILO, is primarily concerned with mobilizing domestic resources to finance an investment-led strategy in Africa. That is, it addresses the savings issue which confronts not only much of Africa but many of the ex-socialist transition economies as well.

I am very grateful to my co-authors for their splendid collaboration, to UNESCO, UNDP and ILO for giving me an opportunity to travel and study widely, to government officials and ordinary citizens in China, Vietnam and Kazakhstan for sharing their knowledge with me, and to Macalester College and the Institute for the Study of Development and the International Economy for inviting me to present some of my ideas to them.

KEITH GRIFFIN

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1 Introduction

The leading issues in economic development are very different today from what they were even a short time ago.[1] This is due in part to conceptual changes, in particular to the rise of 'human development' as a focus of attention and to an attempt to incorporate 'culture' into the analysis of economic processes. The debate has also been influenced by increased international integration and the 'globalization' of culture, politics, the economy and technology.[2] Equally important have been the failures of 'structural adjustment' in sub-Saharan Africa and of systemic transformation in the former Soviet Union and Central and Eastern Europe. Indeed, apart from China and Vietnam, the 'transition economies' have encountered severe difficulty in effecting a smooth transition from central planning to a more market-oriented economic system.

These five leading issues – culture, human development, globalization, sub-Saharan Africa and the transition economies – are the subject of this book. Economic growth, at least since the time of Adam Smith, has been a central objective of policy and the accumulation of capital has been thought to be the means to achieve growth. At first, natural capital was emphasized, or the 'original and indestructible properties of the soil', but as industrialization proceeded, initially in the United Kingdom and later in Europe and North America, physical capital, or the 'produced means of production', occupied centre stage. Most theories of economic growth give pride of place to investment in plant and equipment. In the second half of the twentieth century, however, there was a shift in favour of human capital, i.e. expenditure on education and training, basic health and nutrition, research and applied science. In Chapter 2 I attempt to extend the analysis by introducing culture into the debate.

The essence of the argument is, first, that new knowledge, new technology and new institutions are the ultimate sources of development and, second, that cultural diversity stimulates innovation of all sorts and thereby makes a major contribution to growth and development. A friend of mine, Jan Pieterse, in a caricature of the argument, quipped that 'Multiculturalism is good for business'. In the long run, I think it is, but in the short run ethnic diversity and cultural pluralism can lead to violence, civil war and political disintegration, as we have seen in the former Yugoslavia and elsewhere.

Globalization, the subject of Chapter 3, increases the significance of the debate about culture and pluralism. In contrast to many progressive critics, I argue that global integration is increasing and that on balance globalization is desirable economically, politically and culturally. If anything, globalization has not gone far enough and a strong case can be made for greatly liberalizing global labour markets. The asymmetry between relatively free trade and liberal capital markets, on the one hand, and illiberal labour markets, on the other, is hard to defend, either on grounds of efficiency or equity.

Politically, globalization is exerting a slow but powerful squeeze on the state as we know it. Ever since the Treaty of Westphalia of 1648, the 'model' for international relations has been a society of territorial states, each enjoying full sovereignty and non-intervention in its internal affairs. Each state is presumed to enjoy full equality with other states and there is no supreme external authority. Disputes between states in this 'model' were to be settled privately, by force if necessary. While the Westphalian model never fully reflected actual practice, it approximated reality until the end of the Second World War.

The war crimes tribunals in Germany and Japan, the special courts to try crimes against humanity committed in Rwanda and the former Yugoslavia, the establishment of a permanent international court of criminal justice, the military intervention in Kosovo (a province of Serbia) all attest to the erosion of political sovereignty and the incremental and painfully slow spread of a system of international law. Economic forces, too, are weakening the ability of the state to control its own economy. Free trade and, in its absence, the ease of smuggling make it difficult for states to control the flow of goods (and bads) across their borders. Liberal capital markets make it difficult for states to determine the location of production, to impose high taxes on finance capital or to regulate the exchange rate. Low-cost transport, even with restrictive immigration controls, makes it difficult for states to prevent illegal migration. Sovereignty is indeed at bay.

The state is also being squeezed from below. Globalization neutralizes the advantages of large states in exploiting economies of scale and makes small states economically viable. The spread of international law reduces the need for large standing armies and increases the security of small states. And the quest for greater self-determination, the spread of sub-nationalist movements, weakens the legitimacy of existing states. We are entering an era in which fragmentation of existing states and the creation of looser federations are becoming commonplace.

In many cases these developments can be welcomed. Few now regret that Malaysia and Singapore went their separate ways, that Bangladesh split off from Pakistan, that the USSR disintegrated or that Scotland and Wales achieved greater autonomy within the United Kingdom. The problem is that in a world consisting of a large and growing number of states, our institutions of global governance are weak, undemocratic and poorly financed. The Westphalian model is on the verge of collapse, some sort of a supreme external authority is needed, and yet we cling to the outmoded concept of sovereignty. International governance is bound to be high on the agenda of the twenty-first century.

Self-determination and a more liberal economy can contribute to what has come to be called human development. In Chapter 4 I trace the origins and impact of human development to two central ideas. The first is that the overriding objective of policy should be the enhancement of people's capabilities, i.e. their ability to live a life of their choice. The expansion of output and incomes, i.e. economic growth as conventionally defined, can contribute to the enhancement of human capabilities, but economic growth is merely a means to a higher end, and not an end in itself. The ultimate objective is human development.

The second central idea is the importance of human capital. As mentioned above, human capital formation is a major source of economic growth; the return on investment in human beings can be quite high. Within a human development context, moreover, human capital becomes doubly important since expenditure on human capital contributes directly to increased capabilities (and hence is an end in itself) while simultaneously contributing to increased output and incomes (and hence is an important means for increasing human development). The human development approach also has implications for the role of equality in encouraging development. The return on education and health diminishes as one moves from primary to secondary and tertiary education and from basic health services and preventive medicine to curative health services in large urban hospitals. Thus a more equal expenditure on human capital actually raises the rate of growth of output and the pace of human development. There need be no conflict between equity and growth.

This theme is explored in detail in Chapter 5 in an essay written with Amy Ickowitz. Most economists who have addressed this issue have been concerned with the effects of a more equal distribution of income on efficiency in resource allocation and the rate of growth. Our concern, in contrast, is with the distribution of wealth. The general argument is that in many countries a redistribution of productive assets can stimulate growth, whether growth is defined as an increase in gross domestic product or the attainment of higher levels of human development. A more equal distribution of land, for instance, is likely to result in an increase in employment, a rise in yields (output per hectare) and in higher investment (and savings). A more equal distribution of housing assets will increase human development directly and it will also stimulate investment in home-based enterprises such as restaurants and shops, thereby increasing the rate of growth.

Microeconomic evidence from a large number of countries indicates that private and social returns to investment in education are high. This is supported by the macroeconomic evidence, which indicates that high enrolment rates in schools are associated with higher growth rates. Similarly, widespread malnutrition in sub-Saharan Africa and South Asia impair the life chances of millions of young people and help to explain why human development in those two regions is well below the average for developing countries as a whole.[3] A more equal distribution of all forms of human capital would almost certainly accelerate development.

Access to finance capital is very uneven in developing countries and in the ex-socialist transition economies. Indeed credit rationing is a normal feature of the loanable funds market. Most people are unable to borrow capital unless they possess an asset that can be used as collateral. The implication of this is that the more widely are assets distributed, the larger the number of people who are potential borrowers and hence the larger the number of high return investments in human, physical and natural capital that can be financed. That is, for any given level of investment, the wider the access to finance capital, the higher is likely to be the average rate of return on investment.

A more even distribution of wealth, however, is likely to result in a higher level of investment as well as in a higher return on investment. The reason for this is that in societies in which capital markets are shallow and poorly developed, savings largely depend on investment opportunities. That is, people 'save' (by consuming less or working longer) in order to undertake investment projects. Indeed the saving