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Strategies for Growth and Poverty Alleviation

Robert Cassen

COMMONWEALTH SECRETARIAT

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Foreword

The East Asian development experience is remarkable by historical standards. Over the last two decades, the four East Asian tigers grew more rapidly than other developing countries and achieved impressive increases in living standards. The region has emerged as a major magnet for world trade and foreign investment. The causes of East Asia's economic success have been hotly debated in policy circles and a plethora of economic, political and social explanations have been offered. International agencies have tried to translate the East Asian experience into policy prescriptions for other developing countries in South Asia, Africa, Latin America and the Caribbean with differing rates of success. In an attempt to build a consensus on the factors behind East Asia's success and to formulate best practice lessons for Commonwealth developing countries, the Secretariat asked Professor Robert Cassen to prepare this paper. The principal development issues analysed include: trade and industrial policy, growth, macro-economic strategies, human development and poverty reduction. Drawing on the East Asian experience, the paper proposes an anti-poverty strategy based on three main components: growth, employment and human development. Finally, the paper examines the implications of the anti-poverty strategy for international development co-operation policies in the context of declining aid flows and suggests measures to improve their effectiveness.

The paper was first presented at the Commonwealth Finance Ministers meeting in Jamaica in 1995 and also at a Round Table on Growth and Poverty Alleviation organised by the Economic Affairs Division of the Secretariat in early 1996. This volume contains a revised version of the Professor Cassen's paper, the verbatim comments by discussants at the Round Table, a summary of the discussion by the Secretariat and a list of participants.

Sir Humphrey Maud (KCMG)
Commonwealth Deputy Secretary-General
Economic and Social Affairs

Executive Summary

Part I

Analysis: *Success Stories – the Lessons of East Asian Development & their Applicability Elsewhere*

East Asia's remarkable success has stimulated reflection about its relevance for other countries. The paper argues that these economies do not provide a "model" which can be copied: each country has followed a different path, and has also had unique initial conditions. But they do provide an ***example*** – of self-reliant development, emerging from poverty and backwardness and achieving structural transformation in a matter of three decades; and many features of their experience provide policy lessons which can be learned from and adapted to different circumstances.

The four East Asian economies principally focused on – Hong Kong, Korea, Singapore, Taiwan – have had some common features: high levels of physical and human capital accumulation, and a relatively stable macro-economic environment – with low rates of inflation, non-negative real interest rates, and competitive exchange rates. Human resources have played an important part, both in skills for industrial technology development, and in the high quality of government. Apart from these factors, the driving force in growth was the promotion and achievement of rapidly increasing levels of exports of manufactures.

The four economies have made use of government intervention to differing degrees. The instruments have included selective import protection, subsidised and directed credit, promotion of investment in specific sectors and products by foreign and domestic firms, and strong incentives to exporters (ranging from tax-rebates and subsidies, to prestigious awards and other forms of public recognition). In the vast majority of areas, though, protection, tax-breaks and subsidies were always of limited duration, subject to market disciplines, and conditional on the attainment of export success.

Except in Hong Kong, the financial sector was not in the main "liberal" according to prevailing orthodoxies, at least until relatively recently. Public ownership of banks, public direction of credit, and public control over uses of private savings were all common. But they were skilfully managed, and again governed by objectives of commercial viability; they also operated within the framework of macro conditions already described.

Intervention had other aspects: public expenditure on research and development, and on technological support to business including SMEs; considerable consultation and discussion between government, business and academe on a range of policy and management issues; and a high degree of shaping of education and training policy and practice in both public and private sectors to meet industrial goals. Health and family planning policies complemented those in education and training, contributing to longevity, productivity, and declining population growth.

What can Commonwealth developing countries learn from this experience? Some features – certain forms of protection and of incentives to exports – are now restricted by the WTO. While export promotion by other means is still possible and important, for many countries exports of services, non-traditional agricultural products and manufactures require targeting. East Asian practices to attract foreign investment can profitably be studied by other countries. Methods of consultation between government and business can be adapted in a variety of ways. Other countries can also learn from the East Asian experience of human development, and make more concerted efforts to ensure its contribution to humanitarian and productive objectives.

The necessary conditions for doing these things successfully include: the capacity to sustain a stable and sound macro-economic and policy environment over a long period; a well-trained and effective bureaucracy; and the political conditions which ensure that public policy serves economic objectives, not partisan political goals and self-interest.

Part II
Anti-poverty Strategies: *Growth, Employment and Human Development*

It is argued that a strategy for growth, employment and human development *is* an anti-poverty strategy. Growth is a necessary, but not a sufficient condition for mitigating poverty; it has to be well-distributed growth, with prices and policies conducive to the generation of employment. Getting the macro "fundamentals" right and the ability to manage external shocks are both critical to growth. Promotion of the private sector, exports, and the capacity to adopt improved technologies are further key features. The greatest problems confront the poorest countries where governmental capacity is limited, and where debt and a vulnerable primary-product export "basket" create difficulties for achieving external balance. These are also the countries with least to gain from the Uruguay Round.

A range of measures can help to generate employment. For many countries, raising levels of agricultural employment is a prime requirement. Numerous countries have still to complete the reform of past policies which have prevented the attainment of efficiency and equity in agriculture. Pursuing such reform, together with measures to promote SMEs, will do much for rural employment (and urban employment). Credit, appropriate financial intermediation, technology imports and technological support are critical factors here. Micro-finance such as that provided by the Grameen Bank in Bangladesh or SEWA in India are of particular importance to the rural poor and in the urban informal sector.

The influence of labour market factors is also reviewed. Past policies have attempted to protect labour and enhance worker security, often at the expense of employment. The more these – important – goals can be achieved by means that do not discourage firms from hiring labour, the better for employment. Rapidly rising demand for labour, which is made possible when exports grow quickly, can help labour to be more tolerant of the lack of formally defined security; but well-designed regulatory and other policies can play a positive role.

Technology acquisition and adaptation are facilitated in particular by buyer-supplier relationships in exporting and by foreign direct investment. The latter is also influenced by macro and policy stability, and nowadays also by the availability of low-cost skilled labour, rather than low-cost labour *per se*. Greater pragmatism on the part of governments is now in evidence in creating regimes for multinational investment; and multinational corporations themselves are now more sensitive than in the past to the interests of host countries. While the distribution of foreign direct investment is still heavily skewed towards a few countries, there are numerous countries where such investment now provides a significant amount of employment.

There is much new work on human development; it is not widely known, and potentially of considerable value to countries seeking to renew their human development policies. Human development is the third key strand of anti-poverty strategies. A range of information can be brought to bear to assist the determination of priorities, going well beyond the familiar rate-of-return findings which may be somewhat misleading. Interactions among health, education and nutrition have to be captured.

Much more attention than in the past needs to be paid to the *quality* of services, which is not to be seen as an alternative to increasing quality, but as complementary to it. Private and NGO provision of services play major parts in most countries and also require more attention as opposed to exclusive concentration on public provision. Improving the position of women in all aspects of social and economic development is of over-riding importance; without that, most of the goals of human development will remain out of reach.

Funding human development is not beyond the capacity of many countries, other than the very poorest; but they have to have the political will to correct the maldistribution of public expenditures where they are excessively weighted towards tertiary education and health, benefiting a small (and often relatively well-off) section of the population. Greater efficiency in the management and use of resources in these fields can also yield dividends. It is emphasised that human development should not be seen as "welfare", but as productive investment, most of which has a high payoff for individuals and society. In many instances, governments quickly recoup outlays in the form of saved expenditure in the near term.

Part III
Policies for International Co-operation

Aid available for long-term development is shrinking, in the wake of reduced appropriations by some donors, and competing demands, not least for relief assistance. This makes enhancing the effectiveness of international co-operation all the more important.

The paper suggests that there is relatively little scope at present for major change in the country-allocation of aid. It puts forward for consideration proposals which would:

- enhance recipient ownership of and commitment to aid activities
- improve the functioning of technical co-operation and institutional development
- improve the sustainability of aid activities, i.e. their capacity to survive after donor funding has ended
- enhance aid co-ordination, particularly by drawing aid recipients more fully into aid processes
- continue the reconsideration of structural adjustment policies in the light of their less than ideal record hitherto
- assist human development, by helping countries to formulate new strategies and promote skill development, by assisting financing, by helping countries get user fees right, and avoid their use in ways which penalise the poor, and by other measures
- strengthen governmental capacity, by assisting civil service reform, the improvement of transparency and accountability, and domestic capacity building
- and strengthen the private sector with a variety of old and new measures, including:
    - enhancing donor support for small- and medium-scale enterprises, and for micro-finance, through such means as the new Consultative Group to Assist the Poorest (CGAP);
    - support for privatisation programmes, such as the Commonwealth Private Investment Initiative and other measures;

- new instruments in the World Bank group: a new operating unit within the International Finance Corporation (IFC) for project development promotion; a heightened role for the IFC as the private sector partner for the World Bank group; an expanded programme of intermediary financing; and "mainstreaming of guarantees", a measure to extend the Bank's guarantee capacity to portfolio investors and banks for public sector infrastructure financing.

If aid shortages concentrate both donors' and recipients' thinking on how to strengthen indigenous capacities for development, that might not be altogether a bad outcome.

Plan of the Paper

In Part I, the paper sets out an account of the lessons of East Asian development, and the possibilities of applying them elsewhere. Part II considers anti-poverty strategies under three headings: growth, employment and human development. Finally Part III looks at the implications of all the foregoing for international co-operation policies.

1

Analysis
Success Stories – the Lessons of East Asian Development and their Applicability Elsewhere

1.1 Introduction

The rapid industrialization of several East Asian countries has attracted enormous attention. The paper will refer mainly to the four of these East Asian industrializing economies (EAIEs) which first achieved industrial success in the post-1960 period: Hong Kong, Singapore, South Korea and Taiwan, sometimes known as the "Four Tigers". A longer list of the EAIEs would include Indonesia, Malaysia and Thailand, and today China as well: these are referred to at various points below; the background also includes Japan, whose experience has been important.[1]

The greatest potency of the (chronologically) first four EAIEs is perhaps less as a "model" than as an *example*. They are examples of what developing countries can do for themselves. In 1960 Korea's per capita income was some $325, about the level of a mid-range low-income country today. Now it stands in the region of $8000: it has averaged over 7% annual growth of per capita income over 35 years, and over 9% GDP growth. It received substantial and valuable foreign aid during the earlier part of the period; but the major part of its success is attributable to its own efforts. The growth records of Hong Kong, Singapore and Taiwan have been comparable; and they have far exceeded those of almost any other country.

There have been special features unique to the East Asian experience; but also several which other countries can, if not replicate, learn from and at least partially apply. Two parts of the "success stories" are relatively uncontroversial: reasonably stable macro-economic management, and high rates of accumulation of physical and human capital. The special features are historical and cultural. The more controversial elements lie in trade and industrial policy, and the role of government – though as research progresses, the extent of the controversy is narrowing.

1.2 Trade and Industrial Policy in the EAIEs

Of the four countries, **Hong Kong**'s policies were arguably the most "laissez faire" – but it had certain historical peculiarities: its long tradition as a trading port for the Far East, with a sophisticated financial infrastructure, the formation of large British companies (or "Hongs"), and very advantageous presences of entrepreneurs and skilled workers, both from the rest of the world and from mainland China. It has also specialised mainly in light manufacturing, without deepening its industrial base. In recent years it has been relocating manufacturing to other countries, especially China, and its own manufacturing employment and exports have fallen drastically. In five years from 1987, Hong Kong lost about one third of its employment in manufacturing, and its manufactures exports fell by 8.4% a year. During the same period, exports of manufactures from the other three EAIEs grew apace: Korea's by 10.4% a year, Taiwan's by 9.9%, and Singapore's by a remarkable 19.2% annually. While still prosperous, it is clear that Hong Kong does not have the same capacities as the other three to adapt its manufacturing to changing circumstances.

Singapore was much more interventionist, if in a market-friendly manner, relying in particular on multinational corporations (MNCs) and foreign direct investment (FDI), but being deliberately selective and aggressive in seeking foreign investors and guiding them into activities the government wished to promote. It also set up public enterprises when it thought them necessary; but perhaps the most comprehensive of all government direction of investment was on the human side, pushing forward with education, training and skill development to ensure the existence of a highly skilled and technically well-endowed labour force. These efforts have permitted a continuing movement of production into higher value-added activities as domestic living standards rose.

While both Hong Kong and Singapore were relatively free in their trade regimes, **Korea** and **Taiwan** were not. Both engaged in significant import protection, but at the same time gave domestic firms strong incentives to export. They made comparatively little use of FDI, except where local firms lacked and could not develop technological capacity. A key difference between the two was, however, in emphasis on size of enterprises. As is well known, official Korean policy encouraged and made extensive use of large private conglomerates or *chaebols*. Taiwan, on the other hand, has based its development far more on small and medium-scale enterprises (SMEs). Both were also land-based economies, and had major land-reform programmes which contributed to degrees of income equality unusual in developing countries. (Research today suggests a strong link between income equality and growth of national output and productivity.[2])

1.3 Growth and macro-economic management

When economists examine growth, they look at the changes in the basic factors of production – land, labour and capital. Growth can be accounted for by increases in these factors, or by improvements in their productivity; the latter is usually known as Total Factor Productivity, or TFP. There is no doubt that rates of accumulation of human and physical capital have been exceptionally high, higher than in other developing countries at comparable levels of income. Some authors suggest that most of the four economies' growth is due to this accumulation.[3] (Estimates of TFP growth vary from study to study; these authors find TFP growth to be unexceptional.)

It is possible to question the findings, on the ground that they emerge from a model whose assumptions are untested; other models indeed yield different results. But even if the high accumulation story is true, it does not really answer any questions: it *accounts* for growth, but does not *explain* it – the question becomes why these rates of accumulation persisted so long: since they were mainly private (though with a large public element), they had either to have been subsidised, or to have had high rates of return, in order to be attractive, and to continue over such extended periods without growth falling off. Some of the former socialist economies also had high rates of accumulation, without the same results.

One study accepts the accumulation view, but goes on to explain the high productivity of investment in Korea and Taiwan by industrial policy, which permitted the capturing of complementarities between investments and economies of scale which would not have been possible in the absence of intervention.[4] Though the study probably goes too far when it argues that exporting was less important than some sources claim. While it is right in observing that in the first spurt of Korean growth, exports were still only 10% of GNP, during the later rapid-growth period they varied between over 20% and 30% of GNP; in several products – shipbuilding, chemicals, electronic appliances – export markets were also essential to capturing economies of scale; the investments would not have been justified on the basis of the domestic market alone.

Some other commentators have claimed that *small government* was important to East Asian growth. This is not relevant to the question of whether intervention was effective or not (it may have been highly effective even if it did not take a large volume of government resources). But there is a question as to whether these accounts have measured government consistently. The proportion of government revenues or public expenditure to GDP may appear relatively small by comparison with other economies. But such an appearance is misleading, when in fact there were high levels of compulsory saving that were available to governments to control, and large compulsory contributions out of wages to private funds, such as the state-run Central Provident Fund in Singapore, to which employees and employers are each required to contribute 20% of wages. In other economies these transactions would have been in the public sphere: more taxation and/or more government expenditure.

Another strand in the debate has been dismissal of the value of interventions by attempted demonstrations that the sectors or industries "promoted" by intervention have not done better as a result, or have even done worse. Various estimates purporting to show this have been claimed;[5] but again, the findings are subject to the growing awareness that while data fitted to one model can appear to support one conclusion, fitted to another they may show something different. The important question is whether the assumptions are true. A more realistic model, allowing for economies of scale and other effects, suggests that productivity growth in the promoted sectors was actually higher than in others.[6]

Exports of manufactures were in the view of the present paper highly important to growth. They provided the continuing demand for output, and the high rates of return to investment in physical capital and human skills. They yielded economies of scale for producers not obtainable from domestic markets, and also provided the competitive discipline from which domestic markets were often shielded. They assisted with the transfer of technology.[7] They provided foreign exchange to finance the foreign borrowing which upto the 1980s contributed a large share of investment.[8] They imparted the basic dynamism to these economies which made sense of everything else.

Macro-economic management was of major importance. Deficits, domestic and foreign, were mostly kept at low levels; exchange rate regimes were adjusted from time to time to take account of circumstances, usually in sequence from fixed, to fixed but adjustable, and then to floating (and in Hong Kong in one volatile period, back to fixed); exchange rates were realistic and competitive. Inflation was moderate or low, averaging 3.6% annually in Singapore over 1961-91, 6.2% in Taiwan, and 8.8% in Hong Kong. Only Korea had higher figures (12.2% for the whole period, but 17.4% in the 1960s and 19.8% in the 1970s – still below the 20% regarded by some as an upper limit to manageable inflation in developing countries; the 1980s figure was 5.1%).[9]

While these policies provided relatively stable economic conditions, none of the economies escaped periods of difficulty, in particular those arising from external shocks, especially after the oil-price increase of 1979. But all four displayed good capacity to cope with shocks. This capacity is nowadays regarded as among the most important factors in growth.[10] Stability is important to investors, domestic and foreign; to savers and to the avoidance of capital flight. Exchange rate stability is also helpful to exporters. Debt crises were largely avoided – indeed only Korea relied at all heavily on foreign borrowing to maintain investment levels. High levels of savings and exports meant that capacities to service debt were satisfactory; Korea's foreign debt exceeded half its GNP in 1985, but it never lost creditworthiness, and reduced the debt/GNP ratio to 14% by 1990.

Savings were high in part because incomes were high and growing; interest rates were kept mostly, though not always strongly, positive, and at least were not allowed to become significantly negative, as has proved damaging in several developing countries. Demographic factors played a part, as fertility declines reduced the burden of dependency. Governments also encouraged private savings, both institutionally by promoting banking, post office and other savings facilities, and also by bank regulation to increase the security of deposits; and even by targeted savings schemes and restrictions on consumer credit.[11] They also used tax and expenditure policies to produce rates of *public* savings considerably higher than the norm for other countries. (These would not have been beneficial had they not been channelled effectively into productive uses – which they were, particularly in infrastructure.)

Financial sector policies in three of the four countries did not, at least until quite recently, follow prevailing orthodoxies. Public ownership of banks, public direction of credit with interest-rate subsidies, public control over uses of private savings, were practised to varying degrees by Korea, Singapore and Taiwan (though strict commercial principles were almost invariably followed). On the whole orthodoxy seems right, in that the majority of countries following such methods have often failed with them – even some of the other successful East Asian economies such as Indonesia and Malaysia have had difficulties with them. (This does not mean that financial liberalisation on orthodox lines will always improve matters, as experience in a range of countries has also shown.[12]) As in other fields, the distinctiveness of these economies has often lain in their unusual ability to do hard things exceptionally well. The conditions for this performance in the financial sector included the fact that interest rate subsidies were modest; that officials and banks were highly qualified to assess credit risks and investment profitability; and that much of the credit was directed to export sectors.

It has also been observed that macro-economic policies were by no means straightforwardly "orthodox". An advantage enjoyed by the East Asian economies has been that their external capital flows have been less volatile than in Latin America and elsewhere; a higher proportion of capital inflows has also gone into industrial investment rather than portfolio flows. This has been part of deliberate policy by East Asian governments. These governments have also pursued real exchange rate stability at the cost of some inflation, rather than permit capital inflows and outflows to make the exchange rate appreciate or depreciate; they have also run fiscal surpluses or deficits when macro stability required them to offset private sector behaviour, rather than observing the purity of maintaining fiscal balance. It is therefore not at all evident what pursuing the macro-economic fundamentals necessarily requires, or, to put it otherwise, it seems clear that giving some fundamentals priority may mean relaxing others.[13]

Exports were pursued not only by these means, but a host of others: tax rebates, subsidized utilities, a variety of incentives including such things as awards at public ceremonies for successful export performance, and support instruments such as government-funded industrial parks. High tariffs on selected imports enabled companies to establish a base in the domestic economy, and often to make supernormal profits at home which subsidised initial losses in export markets. Advantages provided to firms were however **strictly limited in time and subject to the requirement that they succeed in export markets,** eventually under fully competitive conditions. "Infant industries" were not just allowed but forced to grow up – if they failed to, their advantages were withdrawn.

A major part of trade and industrial policy was public assistance to the acquisition of technological capability. In Singapore, as noted, the main thrust was to draw in MNCs which had the necessary expertise; indigenous development of technological capacity was relatively limited. Korea and Taiwan, by contrast, made major efforts to enhance not only the ability of domestic firms to master essential technology, but of the economy as a whole to develop its own technological advances. Korea's R&D expenditures (estimated at 2.1% of GDP) are now higher than those of any other developing country, and even than all but a few OECD countries. (Comparable figures for the other three countries are: Hong Kong 0.5%, Singapore 1%, and Taiwan 1.7%.) As noted, Korea's efforts were concentrated particularly on the *chaebols*, but other means were used to diffuse technology, such as by enacting a law promoting subcontracting for products that the *chaebols* were obliged to procure from SMEs; the subcontractors were also given financial support initially. It may well be, however, that other developing countries have more to learn from Taiwan, which established one of the most comprehensive and successful systems of technological support to SMEs to be found anywhere.

It can hardly be sufficiently emphasised what this account is *not* saying. It is not an argument for the old, failed policies followed in many countries. The evidence against broad import-substitution strategies and highly restrictive trade controls is fairly overwhelming; such policies have been detrimental to development in a range of countries. The evidence for liberal trade policies in developed countries is also impressive. The costs of protection to the industrial countries are usually high, and the advantages of liberal trade well-known. It does not follow from these facts, however, that open, neutral trade regimes are appropriate for every country at every stage of development. The East Asian experience does show that selective interventions can work – but only if all the capacities needed to make them work are present, and if they are well-targeted, limited in duration, and combined with sound price, exchange-rate and macro policies.

There is also an important point to be made about "picking winners". It has often been argued in industrial countries that selecting products for national technological effort is something governments should steer away from; their experience in such efforts on the whole justifies such a view, though there are exceptions. But it is somewhat beside the point being made here. In industrial countries what has nearly always been at issue has been massive investments *at the technological frontier*, where risks are high and mistakes extremely expensive. It is an entirely different matter for a country catching up with known technologies, trying to penetrate existing markets, to learn and adapt techniques and ultimately to be able to do their own product and technology development. Of course for these purposes too, governments can fail as well as succeed, and even the four EAIEs have had their disappointments: but at least there are tried and feasible possibilities. Perhaps the principal skill needed by developing country governments in this field is to make good judgments about what they can and cannot do – a subject that is taken up below.[14]

1.4 Human development in the East Asian experience

Economics has not always held clearly in focus the obvious fact that what countries can do depends to a large extent on the abilities of its people and institutions. That focus is clearer today, in part because of "new growth theories" and other research pointing to the contributions made by the human factor in growth and development;[15] and in part because of the East Asian countries themselves, poorly endowed with natural or any other resources save their working people and their heritage. In these countries the statistically measured contribution of primary schooling to economic growth has been estimated as higher than that of physical investment. "Education is the main theme of the story of the differences in growth between Sub-Saharan Africa and the East Asian high performers." At the same time, the East Asian countries have performed better per unit of human and physical capital formation than other countries. "They have been apparently more successful in allocating the resources that they have accumulated to high-productivity activities and mastering catch-up technologies."[16]

Evidently making a success of the human factor in development is not just a matter of sending people to school. Some important features of East Asian public policy, as far as concerns manufacturing productivity, have been:

i a concentration of public expenditure on primary and secondary schooling; and within higher education, on science, engineering and other subjects useful to industry;

ii strong attention to the *quality* of education (in a recent internationally comparable test covering industrial and developing countries, Korean school pupils outperformed all others in mathematics and science);

iii major efforts to stimulate skill development through training by firms and public and private training institutions, including targeting the national development of specific skills considered to be of high priority (here Singapore has had perhaps the most impressive record of all, both generally and in the promotion of, for example, widespread capability in information technology. Perhaps winners *can* be picked in skill development.)

The story of human resource development in the East Asian countries is not simply one of well-focused public policy. A number of factors coincided to make policy succeed. Many of the decisions needed to make for positive progress are taken by individuals and firms. Here information and incentives are important, and governments can supplement these when markets do not provide all the appropriate signals. (It is well known that there are important potential market failures in education and training: for example in capital markets, because people can rarely borrow against future earnings; and in firm-level training where workers can easily transfer to other firms.) Above all, the rapid growth of employment and demand for skills, deriving from the rapid growth of exports, meant that there were high perceived returns to individuals investing in their own human capital.

At the same time, as far as public schooling was concerned, the decline in fertility and population growth associated with rising incomes and the spread of education made it easier for governments both to ensure universal education and to raise its quality. (It is calculated that if Korea in 1980 had still had its fertility level of 1960, the 1960 level of primary education, at 1960 expenditure per pupil, would have cost an extra 1% of GDP in 1980. As it was, Korea was able to raise expenditure per pupil several-fold.)

A further feature of the East Asian experience has been high levels of *female* education. This of course is significant for fertility decline, especially when combined, as was the case, with effective health and family planning programmes. But growth estimates also support the view that female education is valuable for national productivity growth. Even where female labour-force participation is low on average, it is often high in export industries. And the non-market returns to female education (not least for improving the health of populations) are very considerable. The inter-relatedness of these aspects of the human development story in East Asia has acquired the epithet of a "virtuous circle".[17]

1.5 Poverty in the East Asian Economies

The East Asian economies were characterised not only by rapid growth during the last three decades, but also in most cases by improvements in the distribution of income, and reductions in the extent of poverty. Looking at the world's economies as a whole, there were only seven economies which combined high growth and low relative inequality measured over the period 1965-89: they were the four EAIEs, and Indonesia, Japan and Thailand – though the last mentioned had the least improvement. In the decade 1972-82 alone, Indonesia saw the proportion of the population below the poverty line decline from 58% to 17%; for Singapore over the same period, the decline was from 31% to 10%; and in Malaysia (1973-87), from 37% to 14%. As in so many other respects, this performance was exceptional by comparison with other countries.[18]

As has also been apparent in the analysis of these countries, the causes of this performance are not simple, but complex and mutually reinforcing. Significant background factors in Japan, Korea and Taiwan were the land reforms carried out after the Second World War. But importance must also be attached to rapid growth and high levels of employment, including the gradual drawing of women into the labour force, all of which contributed to reductions in wage-inequality. Concentration on small- and medium-scale enterprises (especially in Hong Kong, Japan and Taiwan) helped to make growth employment-intensive. The contribution of human resource investments was also notable – without them, the land reforms would not have led to such great increases in rural productivity and incomes, nor would manufacturing development have proceeded at the pace it did. And several of these factors in turn contributed to falling family-size and slower population growth, making it easier for these economies to continue enjoying high levels of well-paid employment and extension of the coverage and quality of education and health services.[19]

It is also not obvious what is cause and what is effect. As already noted, the connection between growth and equality can work both ways. Growth provides the resources which permit improvements in equality. But equality was also helpful to growth, both by enhancing human development and productivity, and by helping to create satisfactory political conditions. Labour peace, the diminution of ethnic rivalry, the furthering of genuine democracy and social integration were to varying degrees the explicit objectives of economic policy in different countries.

1.6 Japan: a note

While the "East Asian experience" has been discussed here in terms of the first four EAIEs, the discussion would be incomplete without reference to Japan. Japan has of course been in many ways the precursor and role-model for other Asian economies, as well as a major investor in the region, often transferring its organisation and production methods to companies, subsidiaries and suppliers elsewhere. (The Japanese economy has also been important as a driving force in East Asian development: *see* the Comment by Prof John Toye in the present volume.) Japan's economic development has been a product of intensive collaboration between government, academic institutions and the private sector; it has also been a pioneer of production techniques, not only in robotics and other hardware, but in what is sometimes known as "org-ware": lean production, flexible production, just-in-time inventory and so forth.

As Japan has begun to assert financial leadership in international co-operation, it has also made efforts to achieve wider appreciation for what it sees as the Asian experience of growth and development, which Japanese officials and scholars see as much more "market plus government" than purely market driven. It was the Japanese government which induced the World Bank to prepare its *East Asian Miracle* study; it is no secret that the government was disappointed with the study, which it did not feel reflected the Asian experience correctly. The prominence of Japan in the world economy and in co-operation activities implies that more will be heard of their contrasting philosophy of development in future.[20]

1.7 Replicability

If "replicability" means the capacity of less advanced countries to repeat the remarkable success of the "Miracle" countries, one has probably to conclude that success on such a scale is out of reach for many, perhaps most countries, at least in the near or medium term. As has been observed above, that success depended on getting a very large number of things "right" simultaneously, as well as on the capacity to generate large and fast-growing exports of manufactures, which clearly other countries cannot all do simultaneously. Increasingly today, countries, especially the poorer ones, will have to try to increase exports of agricultural products and services. A historically minded study would also place more emphasis on the slow build-up of the capabilities of the East Asian countries; many of the important foundations of their success were built in earlier decades, when educational systems, governmental structures and the main lines of economic policy began to be put in place. There are also the unfathomable questions of culture and society, to which many would attribute considerable importance.

None of this is to deny, however, that there are elements of East Asian experience which others *can* copy. They will not have the same dramatic effect in the absence of the other supporting factors. But they could be helpful. Countries can use some of the same instruments of export promotion and industrial policy. Some policy instruments used by the four EAIEs, however – some measures of export promotion and selective protection – are now not permitted under the new rules of the World Trade Organisation (WTO).[21] There is a question of institutional and even political capacity: whether governments have the abilities necessary to select the right goals and policy instruments – and equally importantly, whether they can *withdraw* incentives and advantages when firms are not succeeding, or after they have fully established themselves.

In human resource development, there is much that other countries can do: the East Asian countries did not just invest heavily in education; they made the right kinds of investment, stressing basic education and the development of abilities and skills useful to industry. In many of the less advanced countries, educational expenditures are heavily skewed towards higher education, and within the tertiary sector, the wrong kinds of education, with overemphasis on traditional subjects emphasised by former colonial administrations, and insufficient attention to science, engineering and management training. Production-skill training institutions are often quite out of date, and policies are not in place to encourage appropriate school curricula and firm-level training.

The Asian experience includes a range of methods of co-operation between government and industry: in Japan the MITI 5-year "master plans", with trade associations, labour organisations, representatives of public and private sectors, consumers and academics coming together in committees to work out consensual approaches for macro-economic and technological policy; R&D consortia, where government and business co-operated to develop specific technologies; and deliberative councils for the sharing of information between economic agents in public and private sectors. Variants of these methods were practised in several of the East Asian countries. Policy was not just about fiscal and financial breaks or incentives; it was also about sharing information, giving technological assistance, overcoming obstacles to exporting, and so forth.

Of course all these things too require a degree of institutional capacity, and some are as yet out of reach for the less advanced countries. But institutions can be developed, and many of these important means of fostering manufacturing and other export success can be learned; they can be initiated in modest ways and built up over time. The important thing is what countries should be *trying* to achieve. The East Asian countries can be seen as examples to be emulated, rather than replicated, by countries further back on the development path, whose experience will inevitably be different. They have shown what can be achieved in a period of two to three decades.

There are new problems today, particularly those arising from globalisation: as noted, the Uruguay Round, for example, makes it harder for countries to practise selective import protection, even though there is evidence that over-fast import liberalisation has undermined potentially viable manufacturing capacity in, for example, some African countries. Once again, one might remember the East Asian countries as examples: while other countries were gripped with export pessimism and "dependency" pessimism, and pursued inward-looking policies, the EAIEs just went ahead and made their break-through on the manufactures exporting front. "Globalisation pessimism" may now be starting as a new inhibition, replacing the old. It is based on real concerns – but not necessarily insuperable ones. There are new opportunities as well as new problems, given the likely expansion of world trade which will benefit a wide range of countries. It is the poorest countries, for whom the Uruguay Round promises relatively little, that face the most arduous struggle.

2

Anti-Poverty Strategies
Growth, Employment and Human Development

2.1 Introduction

Economic growth and employment generation are essential for sustainable human development and poverty alleviation. Growth, because few societies can afford the required social provision without it, and because it is usually essential to employment generation; employment, because it provides necessary incomes, and also gives incentives to individuals and families to invest in their own human capital. A strategy for growth, employment and human development is an anti-poverty strategy; a strategy for growth on its own might not be. But even labour-intensive growth plus access to services may not suffice in many countries – more far-reaching policies including land-redistribution and credit programmes targeted to the poor may be needed.[22]

There has been a debate in the development literature about whether growth leads to poverty alleviation. On average each additional percentage point of annual GNP growth is associated with roughly 0.5% reduction in poverty levels according to World Bank estimates.[23] But that is an average across developing countries; in any particular country, growth may occur without reducing poverty. There is a widespread consensus among researchers that growth is a necessary but not sufficient condition for poverty reduction: appropriate government policies are also essential.

The word "sustainable" in this context is important: trying to attend to poverty and human development by government spending in the absence of growth, or without attention to the productive base of the economy, may if policies are ill-judged only lead to the creation of a premature and costly welfare state. The ambition must be to ensure that levels of social provision are affordable. In a poor country, this may only be possible with the support of foreign aid, but even that must be managed with a view to sustainability: otherwise there may be continuing aid dependence.

2.2 Growth

There are no universal strategies: obviously what fits one country will not necessarily fit another. Some things, however, are fairly universal. The East Asian experience suggests that **getting the macro-economic "fundamentals" right** is crucial to success. This means: avoidance of excessive fiscal and balance of payments deficits, maintaining realistic exchange rates, monetary and credit control, keeping inflation reasonably low and interest rates positive in real terms. Without continuous economic management to achieve these objectives, countries can rarely grow on any extended basis. They cannot provide the stable economic climate which investors and exporters need, prevent capital flight, or cope with inevitable exogenous shocks. (As noted above, management of shocks is critical to growth; countries subject to high deficits and inflation in placid times will be unmanageable when trouble comes.)

The three key engines of growth in late twentieth century development have been the private sector, exports and technology. In recent years most developing countries have embarked on substantial reforms, moving away from heavily-regulated domestic markets and inward looking trade-regimes, encouraging direct foreign investment, privatising or otherwise reforming state-owned enterprises (SOEs), in general placing their economies on a more liberal footing. (The same process has occurred in most formerly socialist, now known as the "transitional", economies.) But the results have been highly variable.

Part of the difficulty has been that many of these reform episodes have occurred in the midst of economic crises, and under World Bank and IMF structural adjustment programmes. Very frequently a period of stabilisation has been necessary, involving retrenchment in demand. Typically even where programmes have been reasonably successful, private investment has needed five years to rise to growth-enhancing levels, partly for demand reasons, partly because a period of that order was needed to convince private investors that the new policy regime has commitment.[24]

Partly, however, it is apparent how much has to be done financially, fiscally and in trade and foreign investment regimes, and how much institutionally, before the private sector can flourish where previously it has been subject to major discouragement. The more pervasive the previous impediments, the more severe the economic crisis which precedes reform, and the weaker the country's government and institutions, the harder it is. African economies in particular have found the going extremely difficult.

With all the enthusiasm for market reforms, there is a danger that the **role of government** in fostering the private sector may be relatively neglected. In addition to establishing macro-economic and policy stability, governments have to provide the physical and institutional infrastructure that facilitates investment. Key institutions include tax administration and implementation, legal and regulatory bodies, and of course the civil service itself. Where financial institutions are weak or inefficient, governments may have to play a part in helping to establish the banking sector, though without impairing its autonomy or absolving it from commercial disciplines. Governments also have major responsibility for human development – *see* below. These are all fairly standard necessities.

The most difficult questions concern **trade and industrial policy**. As noted above, the East Asian countries were, if to varying degrees, quite interventionist in promoting manufacturing development and exports, while for the most part maintaining market discipline. How far their example can be followed by other countries is in part a question of political economy, in part a question of governmental capacity (and in part it is also related to the stage of development). One African author states flatly, for example, that "African governments do not currently have the capability to implement an industrialization strategy by 'getting prices wrong'."[25]

This does not mean that they cannot or should not do any of the things that the East Asian countries did. They may exercise care in import liberalisation – over limited periods – to ensure that viable enterprises are not destroyed by foreign competition before they have a chance to establish themselves; they can provide incentives to exporters which do not infringe WTO rules, such as national honours and awards (much employed by the EAIEs); they can do much to attract FDI and promote technological development. What the author in question is making is in part a political-economy point, relevant to the East Asian history of promoting specific products made by specific firms. As he says, "African governments should avoid reforms that foster a rent-seeking private sector, including overvalued exchange rates, administrative allocation of import-support to the private sector, external commercial debt-conversion schemes, and tax breaks for promoting private investment." He could have added subsidised directed credit, which has had a poor record in Africa.

While all these instruments were used in East Asia, those governments had the personnel to judge the capacity of the targeted firms to make good use of their privileges; even more important, they had the political ability to remove the inducements once companies were successful, or if they were clearly not going to succeed – capacities that may be in short supply elsewhere. Many of the forms of intervention employed in East Asia were justified by market failure; in African – and other – countries "government failure has proved to be a bigger problem than market failure." In several countries there is perhaps still too much government intervention in the economy rather than too little, even while important government functions such as the maintenance of law and order, and the provision of essential services and infrastructure, are incompletely fulfilled.

In earlier discussion of the East Asian experience, mention was made of a variety of ways in which representatives of relevant bodies came together to discuss collaboration between business and government, research and development, technology support, sharing of information, overcoming export obstacles, and so forth. Variants of these methods of promoting manufacturing and other exports can be used by any country. Japanese technical assistance has promoted the use of small group meetings for such purposes in African and other countries. While obviously replication of East Asian practice at its fullest may only be within the grasp of the more institutionally established countries, most countries have things to learn from the East Asian successes. What is important is openness to such learning, and flexibility in the application of the lessons.

2.3 Employment

In most developing countries, the majority of the labour force is engaged in agriculture and agriculture-related activities.[26] Where this is true, any employment strategy must give considerable priority to the **agricultural sector**. The sector is among the hardest to reform. Whatever the stage of development, as Europe knows well, it is difficult to keep prices at a level accepted as sufficiently remunerative by farmers, and affordable to consumers. Developing countries have the same difficulty, but they have often compounded it by limiting incentives to farmers, by reducing competitiveness, by isolating farming from world markets, and by a variety of other marketing and restrictive arrangements which result in low productivity. In addition, governments have very large subsidy bills, directly to food prices, or to inputs, often amounting to significant percentages of GDP; and the input subsidies are often garnered more by the larger and better-off farmers than by the smaller and poorer. Where agriculture serves neither equity nor efficiency, it will not make an adequate contribution to growth, employment or the relief of poverty.

What needs doing is mostly familiar: reducing biases against agriculture in prices, taxes and exchange rates, and diminishing input subsidies such as on electricity, which encourage capital- rather than labour-intensive methods, and are expensive in government revenue terms. Agricultural research and extension are also often underfunded and poorly managed, despite their having very high pay-offs in terms of raising agricultural productivity. Rural credit is often critical, but all too frequently prevailing systems subsidise larger farmers with cheap credit, *and* have low recovery rates, so that credit institutions fail to help poorer farmers, and become financially unviable.

Some of the difficulties of removing biases are political in the less desirable sense, for example, when it is hard to reduce or take away benefits once granted because the recipients are powerful although not in need; others are political in the more defensible sense, that governments are worried about food price increases which impact on the vulnerable under reform. But in general it is better to cope with distributional questions by food stamps or other schemes, rather than by tampering with production incentives. Many of the policies which harm agriculture have been motivated by food security and similar concerns; they are ripe for reconsideration, if markets can produce higher productivity while food security can still be maintained.

A variety of targeted schemes have also proved valuable in stimulating agricultural growth and employment, particularly those aimed at small farmers. They include community and regional infrastructure projects, land and crop development, rural public works, and micro-savings and credit schemes. The latter include the well-known Grameen Bank in Bangladesh, SEWA (the Self-Employed Women's Association) in India, and Indonesia's Badan Kredit Kecamatan. The record of such measures has been quite strong in Asia and Latin America, less so in Africa. Specialist agricultural exports have also been helpful. While escalating tariffs in most industrial countries militate against development of processed agricultural products, several countries – Kenya is a notable example – have generated valuable exports in specialist fruit, vegetable and other horticultural products. They are commonly grown by smallholders, though they may require relatively sophisticated marketing techniques and infrastructure.

Apart from its direct impact on employment, a thriving agriculture is important because of its ability to stimulate off-farm employment in ***small- and medium-scale enterprises (SMEs)***. A number of countries have had major success in contributing to growth and employment through SMEs. Perhaps the most spectacular case has been China, whose "Township and Village Enterprises" (TVEs) have been the mainstay of its recent economic growth, apart from the joint-venture sector with foreign participation. The TVEs rose from a modest presence to over 40% of rural output and employment in the space of some ten years, beginning with the economic reforms of 1979. These have now expanded outside agriculture-related activities, and are substantial manufacturers and exporters; but they began with agricultural processing and supplying inputs and consumer goods to increasingly prosperous farmers benefitting from agricultural reform. The key policy instrument, apart from making it legal to start such enterprises, was credit.

There have been notable developments in the SME sector in other countries, including India, Indonesia and Malaysia. A lot depends on linkages with the farm sector, which seem to be weaker in Latin America, dominated by estate and commercial farming, and in Africa – perhaps because of relatively low use of purchased farm inputs – than in Asia. The critical policy ingredient in SME success seems to be finding appropriate forms of financial intermediation for this sector; and technology imports and technological support. These are also important to employment.

The principal means of **technology** acquisition by developing country firms are through FDI and buyer-supplier relationships – apart of course from purchases of technology and, usually at a later stage of development, domestic R&D. For much of recent decades, developing countries have treated MNCs with suspicion – not without reason. By transfer pricing and other means, MNCs could often manage to produce large profits for themselves, and few benefits for the host countries – though this was sometimes the result of policy distortions in the host country. The transfer of technology was often something MNCs specifically failed to do, or avoided doing, excluding host-country personnel from technological learning. These and many other things have changed. Developing countries have learned to make better judgments about when an association with a MNC will benefit them, and also to negotiate more successfully with them; but the case-by-case approach has pitfalls, and the aim should surely be a regime which creates a "level playing field" – certainly not one which confers uncompetitive benefits on MNCs. Over the years the corporations themselves have also seen the virtues – and often higher profitability – in engaging in closer and more mutually advantageous relations with the host economies.

The result is that developing countries today are making much greater efforts to attract FDI. But only a few succeed. While FDI flows are large, they are concentrated on a relatively small number of countries; over two-fifths (42%) of all 1994 FDI flows to developing countries went to China (*see* table below). A small number of other countries in Asia (Singapore, Thailand and Indonesia) and in Latin America (Mexico and Argentina) account for the bulk of the rest. Nevertheless, even if not major sites for FDI in absolute terms, countries as varied as Barbados, Botswana, Mauritius and Sri Lanka owe more than 20% of their modern manufacturing employment to MNCs.[27] Malaysia has had perhaps the most spectacular sustained growth of exports in East Asia in recent years, related largely to MNC investment in computer chips.) The things that make for economic growth are ingredients in the attraction process: macro-economic and policy stability, well developed infrastructure, institutions and business climate, and also good levels of human development – there is evidence that much MNC investment today is attracted by low-cost skilled, not unskilled, labour.

Table 1: **FDI in Selected Major Recipients in 1994**

	US$ millions
All developing countries including	80,102
Asia and Pacific	**47,600**
China	33,800
Indonesia	2,700
Malaysia	5,200
Thailand	2,100
South Asia	**1,275**
India	620
Pakistan	
Sri Lanka	
Latin America and Caribbean	**16,230**
Argentina	1,282
Mexico	7,978
Sub-Saharan Africa	**2,415**
Angola	350
Nigeria	850

Source: World Bank data

The foreign investment regime is also significant. Under economic reforms, numerous countries are undoing the restrictions on FDI that have inhibited foreign investors in the past. Requirements for majority shareholding by host-country firms, restrictions on profit repatriation, and other obstacles have had to go. But these usually need to be coupled with liberalising reforms in the domestic economy. India, for example, is finding it possible to attract much needed foreign investment for power development; it had not only to make conditions more propitious for the foreign investor, but also to open up the energy sector to private enterprise.

Exporting itself contributes to acquiring technological capability. A growing proportion of manufactures are no longer produced "blind" and then sold to whatever buyers can be found; they are made to specification, for client-specific orders. This of course requires information technology, marketing, design and other skills, and a high level of quality control. But in this process, buyers will often assist supplying firms to acquire the necessary capacities, whether they are Japanese car manufacturers getting parts made overseas, or European clothes and fashion chains seeking low-cost garment suppliers. Special export processing zones may help countries whose overall infrastructure is thin to get off the ground.

A final area important to employment is that of **labour markets and labour regulation**. Most countries have a variety of forms of worker protection and labour standards, ranging from minimum wage to employment legislation and regulation, and commonly including important roles for trade unions. Their record is rather mixed, and at least sometimes harmful to labour or sections of it. Overall, experience suggests that the demand for labour is more important than anything else for employment and working conditions; and that the more that can be done to enhance worker security and conditions by means that do not affect firms' hiring decisions, the better.

Evidence on the experience of minimum wage provisions is both pro and con. In industrial countries, there is mixed evidence, but recent work in the US has shown increases in the minimum wage not to have harmed employment in some areas. In the industrial countries too, a minimum wage is likely to be of benefit to low-paid workers, even if it may sometimes inhibit the employment of the worst paid. There is some evidence too that it may have a role in enhancing worker commitment. In the poorer developing countries it is rarely of significance to the low-paid, who work in rural and urban informal sectors – in fact it is quite likely to work to the disadvantage of poor workers who seek formal employment, and who are better off so long as their pay is higher than in the informal sector. Even in the formal sector, minimum wages are often legislated but not enforced.

Perhaps the regulations most harmful to employment are those which restrict firms' ability to lay off workers, such as exist in India and Sri Lanka. The result is commonly a tendency of firms to prefer casual or short-term hiring and subcontracting, and the practice can serve as an inhibition to new investment. Requirements on firms to provide worker benefits such as maternity leave and pay may also prove an impediment to women's employment; if such benefits can be organised through social security systems, as happens in several of the Transitional Economies, the impediment is removed. More broadly, to any extent that worker security can be provided – by such means as employment guarantee schemes, public works programmes and so forth – rather than through charges on firms, the better the prospects for employment of poorer workers.

This is not at all to say that labour regulation and benefits have no place. There are many whose functions are positive – safety and health regulation, statutes against child labour (on which also see the discussion below) and against all forms of discrimination in hiring. Worker benefits and security organised through the firm can also enhance productivity and job commitment – but then it will be in the *firm's* interest to put such benefits in place. This is a different matter from legislating for such benefits – much depends on the context for the results of any labour legislation and regulation.

2.4 Human Development

When economists have in the past talked of investment, although there was a respectable history of attention to human capacities, investment was usually a matter of factories and buildings, roads and power-plants. "Human capital" in the growth literature was until relatively recently discussed mostly as an adjunct to physical capital. In the last few years years there has been a spate of literature on "human development", which has been particularly concerned with the humanitarian side of social investment. It has served in particular to establish human and social welfare as the principal objectives of economic development. But economists have also become much more aware of the range of economic and other benefits from investing in people.

There are two strands in the human development (HD) literature. The first considers HD as an output and goal of economic development. The second strand is the "input" approach, focussing on productive aspects – the various means by which HD contributes to industrial, social and economic goals. The productive aspects of HD are interpreted here to mean its contributions to productivity, growth and competitiveness in manufacturing, agriculture and services; and its contributions to individual welfare, social integration and avoidance of social costs.

Determinants of education and health: findings of recent research

At a national level, there is a broad correspondence of social indicators with per capita income: the higher the level of income, the more governments and individuals can afford to spend on basic services. But as is well known, income is far from being the only determinant: if for any indicator one plots a curve relating its level in each country to per capita income, there will be a considerable spread of countries around the curve, with some distinct "outliers" well above and below it. Very commonly if it is a health indicator, a large part of the variation from the curve is associated with education, particularly female education.[28]

This is true even at relatively high income levels: several of the higher-income developing countries whose life expectancy is below the average for its level of income are countries where female education is relatively neglected. The same is often true for the outliers, positive and negative, at low income levels – the extent of female education will often prove to be a key factor. Female education has been found to be the most important single positive correlate of life expectancy in the developing world.[29] Yet income is also one of the principal determinants of education level.

One could say that the national level of income is an indicator of capacity to afford the activities which produce given levels of social indicators; how far that capacity goes will be a function of many things – the extent of poverty and the distribution of income; policies; cultural, religious and political factors ... And it must be remembered that a few, exceptional societies have achieved high levels of human indicators at relatively low levels of income: China, Sri Lanka and the State of Kerala in India.

Population growth and high fertility play a part. Although many aspects of the link between population and development are still controversial in the research community, the specific links with human development are much less so. At the national level, one of the few cross-country regressions in the field which is significant and negative is that between population growth and educational expenditures per pupil. The faster population grew in the 1980s, the less was spent.[30] This is not surprising, since education budgets typically grow slowly, while school populations grow quickly.

At the *household and individual level*, the effects of high fertility can be seen from household surveys. There is in fact considerable, though not uniform, evidence for negative consequences to children of having large numbers of siblings; and for mothers in bearing them.[31] Not all the consequences for children are purely related to the number of siblings. Children born less than eighteen months after a previous birth have a risk of dying roughly twice that of a child born after an interval of two years or more; and children born to young mothers (less than 18 years), or very much older mothers, also have higher than average mortality risks. It is commonly the case, though, that short birth intervals and early and very late births are associated with high fertility. Much the same is true of maternal mortality: it is a function of both age and the number of children a mother has, as well as the socioeconomic setting. It is also a function of whether births are wanted or not – one of the highest mortality risks for mothers in developing countries is from unsafe abortion. When all the risks for mothers are joined together, it is clear that bearing numerous children is a dangerous activity for Third World women: a woman experiencing high fertility levels common in Africa has about one chance in six of dying as a result. It is also in some respects restrictive of life-opportunities: at such fertility levels, a woman will spend one-third of her adult life in pregnancy or lactation.[32]

The number of surviving children also affects parents' investment in their children. Two main effects have been studied: the impact on children's nutrition, and on their education. It seems that when socioeconomic conditions are poor and fertility high, there is not much effect. This is not as paradoxical as it might seem. Certainly as far as education is concerned, very poor families who are barely sending children to school and who are having six or more children will not differentiate much among their children; and when everyone's nutrition is low, again few differences among children may be observed. The main differences are found when the number of children is in the range of 4-6, and real economic opportunities exist. At these mid-range family-size levels, two conditions are present: a higher proportion of children are unwanted,[33] and there are both incentives to parents for educating their children, and higher costs of doing so.

There is also a negative association of family size with educational attainment. Again there is often a particular effect on girls – in education, especially the older girls in the family, who are the more commonly made to sacrifice for their younger siblings or, more frequently, brothers.[34] If girls do not receive an education, they will themselves as adults be more dependent on their own children; they will for that and other reasons be likely to experience high fertility. There is a strong likelihood given these difficult socioeconomic conditions of the intergenerational transmission of poverty, high fertility and poor human development.

The household effects are likely to be compounded by societal ones in a low-income country. One thing that is fairly constant independently of the level of development and the stage of the demographic transition is that household educational expenditures per child decline with family size. If rapid population growth dilutes governmental per-pupil expenditures on education, the effect at the household level is reinforced. If in addition fiscal revenues are compressed by slow growth or the need for adjustment, the consequences for poor families of the combined squeeze on private and public resources can be severe.

Of course there is a two-way effect: high fertility and rapid population growth may slow the rate of human development. But human development helps to reduce mortality, fertility and population growth, and thereby contributes to further improvement in the future, breaking a part of the inertial restraint through the population mechanism.[35]

There is a complex of interrelationships among social investments. **Education** is in some sense the key sector: it has more widespread links with other aspects of development, and contributes more to other objectives than the fulfilment of those objectives does to it. Further, the educational system can serve as a "delivery" vehicle for other social sectors. Research has concentrated on relations with health; with fertility; and on the returns to educational expenditure. There are also of course important effects on productivity; these are treated in a later section.

Education and health

Positive relationships between education and health, of the educated *and* their children, are fairly well attested, even if the mechanisms are uncertain: via nutritional knowledge, via greater likelihood of demanding and using health services, via knowledge of disease transmission. It may be even more general, through socialisation and modernisation, and through increasing female status within the family, with consequences for family resource allocation to children and health.

Not all studies show female education to be more important at the aggregate level; but the widespread tendency for mothers to be the principal health-carers for children within the family is one of many considerations which emphasise the importance of female education. The path may be through income: educated mothers will earn more; and mothers' income in many settings may have several *times* the effect of fathers' income on children's health and nutrition.

Education and fertility

Again the relationship is well attested. The "mechanism" by which it works has three components: those which affect exposure to the likelihood of childbearing, most importantly age at marriage; those which affect desired family size; and those which affect the ability to regulate fertility. Many of the consequences of education, from changing aspirations and labour market effects, to better understanding of contraceptive use, play significant parts. Since improved child survival contributes to fertility decline, and fertility decline contributes to mothers' and children's health, there are many possible interactions and causal sequences.[36]

Rates of return to education

Rates of return to education have been much studied at the micro level, and found to be sizeable and positive. A much quoted finding is that the highest returns are to primary education, then to secondary, and the lowest to tertiary. It is probably time to abandon this piece of conventional wisdom – not because this is the wrong order for the relative priorities of the three levels of education, but because the rate-of-return studies do not show them to be so; and as a generalisation, it may be somewhat misleading for educational policy. A much wider range of factors than conventional rate of return estimates must be examined to determine educational priorities.

Further complex interrelationships are found with **health.**

Health and productivity at the micro level

Both old studies and new testify to the relationship, but it is not strong at the individual level. The "old" studies include examples such as the influence of tsetse fly or onchocerciasis on land-use; the role of malaria and other diseases in worker productivity; the relations between iron supplementation and labour productivity. More recent studies have shown significant relationships between health/nutrition and educational performance;[37] or between health and income. The strongest effects occur among the very poor.

Health and fertility

Health affects fertility, first, via fecundity – the ability to conceive. There is not much evidence that nutrition is important, except under acute deprivation. Malaria and other diseases ***do*** affect fecundity. So some health improvements may increase fertility. But still, second, the main expectation is that better child-survival is important for fertility decline where fertility is high and children are regarded as economically important to families. Since parents' education affects child survival, this is yet another avenue of the education-fertility relationships, and illustrates further the complexity of interactions.

Fertility also affects health. As already noted, under prevailing conditions of childbirth in most developing countries, risks of maternal mortality are high. There is also evidence that child numbers and spacing influence child survival. Where contraception is not available and unsafe abortion is resorted to, there is an additional major source of female mortality.

Health interventions

It is well known that it is hard to account for health improvements. It is also important not to attribute too much to the health care system. The principal factors are easy to list:

- ❖ Health care (government or private)
  - technology, organisation/management, expenditure
- ❖ Non-medical factors
  - environment (housing, water, sanitation, air quality, workplace)
  - reproduction (age, parity, spacing)
  - nutrition (agriculture, food, prices)
  - the economy (income, employment)
  - household capacity (role of women, education, motivation)

What is less easy is to understand or predict are the interactions among the various factors, which makes for difficulty in determining priorities in health. The situation is further complicated by the fact that economic development does not have unambiguously positive effects on health. The problems of the "epidemiological transition" are becoming more apparent, as countries move from conditions in which the main problems are those of maternal and child health and communicable diseases, to those of chronic and non-communicable illness, often related to economic growth and sometimes bringing – if sufficient progress has been made with the first set of conditions – rising mortality. The "modern" pattern of disease may include lung and other cancers associated with smoking and environmental conditions; heart disease; and industrial and traffic accidents.

A new factor in the epidemiological transition is AIDS, which has particularly devastating social and economic effects. There is uncertainty about the likely effect of AIDS on mortality; though even at the currently anticipated worst, for example in Africa, it does not do more than keep mortality from falling to where it would have declined otherwise. (Only one or two epidemiologists suggest AIDS could generate actual population decline in the countries of greatest prevalence; their views are not widely shared.) The consequences for attitudes to fertility and other social matters are incalculable.

Relations with poverty

Human development relates to poverty bidirectionally: incomes, health and nutritional status affect people's access to and ability to benefit from services; and their education and health have important consequences for their ability to earn income. As with all these relationships, there are of course numerous mediating variables.

Personal income as a determinant of human development

Very obviously people's incomes play a major part in their health and education. Income is, first of all, a major determinant of nutritional status. This does not mean that raising income is the only important means to overcome malnutrition. Studies show that increases in the income of the poor are not always well spent nutritionally. The imperfect correlation of household income with nutritional status relates also to education and other variables; but also to health status and community variables influencing health: a study in one country concluded that "household food availability does not appear to be the most binding constraint on children's nutrition" – the health of parents and children was also important, with water-supply, sanitation and other community inputs which contributed to health playing a significant part.[38] Clearly where protein-calorie deficiencies are large, income and food availability will be essential; but very commonly they cannot by themselves address the nutritional problems of the poor.

Income is an important determinant of access to services such as health and education. The children of poor families will be under more pressure to earn money, or do household tasks that release their parents for gainful employment. They will also lack the means for the direct costs of attending school: transport if the school is far away, writing materials and the like, uniforms where those are demanded. Since education is more and more becoming a self-help or fee-paying activity, the poor will be the less able to participate. But access to education also relates to other factors, such as ethnic or social characteristics which form the basis of discrimination. Here again there is a web of circumstances which combine to penalise the poor and to keep them poor, since very often poverty itself is associated with social groups disadvantaged in a variety of ways.

This set of issues raises one of the key problems facing the policy-maker wishing to promote human development, namely that of supply versus demand. All too often the job is thought to be done when supply is attended to, whether it be school places (even school places made suitable for girls where this is important), or health clinics. In the case of education, it is very often the same thing that makes people poor that keeps their children out of education: if they possess some characteristic by which they are discriminated against in the labour market, their children, facing the same discrimination, will find the return to schooling lower than it should be, and parents will be discouraged from making sacrifices to put their children through school.

Another important factor is the lack of attention poor parents (and sometimes not-quite-so-poor parents) may give to children in specific ways important to their development. This is not just nutrition and health, but intellectual and social stimulation of a kind which assists a child's mental and emotional development. There is considerable evidence that what happens to a child in the first four to five years of life is critical, sometimes irrecoverable, in determining her later progress.[39]

Human development as a determinant of personal income

The rate of return evidence cited above, however imperfect, bears clear witness to the potential role of education for improving the incomes of the poor. The poor are commonly asset-less, and human capital is among the most important (and least expensive) assets with which they can be provided. The section on productivity in manufacturing and agriculture below provides further evidence.

As already noted, education contributes to the health of the educated and their children. But health also contributes to education: again, there is widespread evidence that ill and poorly nourished children perform less well in school. Both health and education are important to improved survival prospects for children and for lesser fertility, leading to the smaller families in which human development is more likely to be well provided for.

It goes without saying, of course, that other assets are of crucial importance as determinants of poverty and wealth. Ownership of land, or secure rights to land-use, access to common property resources, and credit, together with other productive resources are all important matters which have to be addressed in an anti-poverty strategy.

Education and health as factors in productivity growth and changing comparative advantage

A range of factors bearing on productivity at the micro level has been referred to above. But some of the most interesting recent work on development points to major roles for human investment as contributing to growth at a national level. Among the most remarkable findings are some historical ones: there may well be a link between inequality, health and economic growth: one study attributes "about 50 percent" of British economic growth between 1790 and 1980 to "the increase in dietary energy available for work, and of the increased human efficiency in transforming dietary energy into work output".[40] Historically improving diet in both Britain and France in this period affected the lowest quintiles of the population in particular – in the 18th century a significant proportion of them had insufficient dietary energy to work, or to work more than a few hours a day.

New inter-country estimates incorporate education variables which explain a considerable share of economic growth.[41] And the phenomenal growth of the East Asian countries has been noted above to be due to a considerable extent to their human investment. The World Bank's model for the high-performing Asian economies predicts some two-thirds of their observed growth; of that predicted growth, primary education accounts for more than does physical investment – from 58% of predicted growth in Japan to 87% in Thailand .[42] Secondary education also makes a sizeable contribution to growth in the countries where it has been encouraged most strongly – ie not in Indonesia, Malaysia and Thailand, which have neglected the secondary level and are now trying to compensate for it.

An important part of this has been the world of manufacturing itself, where firstly, competition has been widely seen to have been affected by "lean production", "flexible production" and other changes, and secondly, countries facing competition from new lower cost producers as their own wages rise have had to "upgrade" their products and product-mix to succeed in world markets. It is well known that this has much to do with human skills; even in the industrial countries, or some of them, falling behind in the skilling of the labour force has been a frequent topic in the media as well as academic research.[43]

But studies also show significant effects of human investment on agricultural productivity, at least where agricultural technology is changing; parts of the service sector too, which are now major contributors to many developing countries' GDP and exports, undoubtedly depend on human skills, though this field is under-researched.

If investment in human resources contributes to economic growth, there are also estimates of the cost to growth of failing to invest. Birdsall and Sabot find "a potential increase in current per capita income of 25 percent had Pakistan had Indonesia's 1960 primary enrolment rates, and a potential increase of 16 percent had Pakistan sent as many girls as boys to school in 1960."

A further strand of recent research is on skills and trade. Models explaining countries' trade patterns in terms of their factors of production are being re-developed, and the importance of skills in exports of manufactures is now seen in a new and emphatic light. It may well be that Africa's problems in diversifying out of mainly primary exports lie more in deficiencies of education and training among the labour force than any other factor.

Women in development

Background papers for the 1995 Beijing World Conference on Women documented the fact that a large proportion of the world's women live under impoverished, inequitable and politically discriminatory conditions. But improving women's economic opportunities and well-being is not just a matter of equity; it is also a matter of efficiency. As so much of the account of HD above testifies, a large proportion of the positive societal effects of investing in people depends on improving women's lives in particular. And as the section on productivity makes clear, women in the labour force have much to do with national economic success, particularly, in the more advanced economies, in export sectors. There should be no need, in a paper on development strategy, for a separate section on women: they are half the population, and important for every aspect of development. But as long as they continue to be subject to discrimination and subordination, their roles will require repeated emphasis.

Again and again in research findings, taking action in social provision to improve women's position and agency comes out as a key overall priority. It is women's education that has the greatest effect on children's health and on life expectancy in society at large. It is mothers' rather than fathers' incomes that have the greatest effect on children's education and health. It is female education that does the most to encourage families to have fewer children, and thus lead to a diminution of population growth. Even in the measured effect of education on national productivity growth, as already noted, female education is often found to be highly significant. In much of Africa, there is often a division of labour in agriculture, women growing food and men cash-crops; in these circumstances, education, credit and extension services for women can play a major part in food production. Women commonly work as hard as, or harder than, men, but usually for lesser rewards; in many situations their work is not regarded as even subject to reward. In general both equity and efficiency demand that the position of women be advanced relatively and absolutely.

Policies

There has been more new thinking on human development in recent years than on most development topics. What constitutes an appropriate human development strategy today is quite different in emphasis from earlier conceptions. There is more concentration on productive as well as humanitarian goals; more emphasis on private and NGO provision and activities, even while government remains a key actor; there is a greater understanding of the importance of the demand for services, as opposed to thinking mainly about their supply; and of the significance of the quality of services, as opposed just to their quantity. In addition, a great deal of research has been brought to bear on what works and what does not, and on how to approach the design of strategies.

Perhaps the first point to be made is a conceptual one: human development is no longer thought of as "welfare", as a cost to the state. It is, as was said earlier, both a main goal and an instrument of growth, and it has potentially high payoffs to government as well as to society at large. Every country is unique in its history and culture, and in its stage of development, and will therefore seek different things from human development policies. But there are many common elements in how to tackle their formulation.

There is no simple recipe for **establishing priorities** in the areas of education, health, fertility, and poverty. Instead, there is a range of information which can be gathered. Rate of return studies in education will give a preliminary indication, but they have their weaknesses.[44] The state of the labour market, skill shortages and information on levels of education required for current and prospective jobs give further direction for educational planning. Studies of interactions among inputs and outputs give yet further guidance: of the effects of education on health, nutrition and fertility; or of health and productivity. The health sector has to be studied in relation to the incidence of health problems, and the cost effectiveness of measures to address them, taking account of the importance of non-health inputs such as education and improvement of environmental factors in health. It cannot be over-emphasised that again and again in research findings, rectifying *gender imbalances* in social provision comes out as a key overall priority.

Having gained by these means some indications of priorities, the next step is to pass **from priorities to policies**. Here further ranges of information have to be brought to bear. Expenditure surveys indicate what is actually happening: in India for example, more than 80% of actual health expenditures – including expenditure by the poor – are *private*. While government provides much of the essential health network, control of communicable diseases, and other public health measures, unless there is attention to the quality of privately supplied care and access to it by poor people, the nation's health problems will not be addressed. This is true in many countries. In some African countries as much as 30% of public health facilities may be provided by voluntary organisations; without paying attention to the voluntary sector, again an important part of the picture is missing.[45]

Similarly in education, the role of private and voluntary activities is of major significance. While in most countries primary education is rightly seen as the responsibility of government first and foremost, there are important functions of the private and voluntary sectors. Schools are built by local and self-help communities in several countries. Private expenditures on education, again by the poor as well as the better-off, are often considerable, and private schools are often more cost-effective than public ones: private schooling with vouchers for poor people to attend may make contributions which the public sector cannot.[46]

Supplying services is far from being the end of the story, whether it be school places (even school places made suitable for girls where this is important), or health clinics. In the case of education, it is very often the same thing that makes people poor that keeps their children out of education: if they possess some characteristic by which they are discriminated against in the labour market, their children, facing the same discrimination, will find the return to schooling lower than it should be, and parents will be discouraged from making sacrifices to put their children through school. **Demand** for services has to be looked at too.

This is nowhere clearer than in the field of child labour. It mainly takes place in the small-scale and informal sector, often in occupations traditional to a family and either in or near the home. It has in most countries resisted legislation, and is hard to monitor because it takes place at so many sites. Trying to prevent it would, in any case, often penalise the poor. The most that legislation has usually done has been to prevent children from working in particularly hazardous occupations, and in the formal sector.

There are two main areas of policy: one is in education itself – lack of access to education (distant, unsuitable or malfunctioning schools), low quality education with high dropout rates, or in some settings, high costs of education, can all be factors leading to child labour. Flexible schooling hours, teaching adapted to children's needs – especially non-academic curricula – even mobile and other inventive forms of schooling have all been tried with positive effects. Second, parents' incomes need to be enhanced so that they can afford to lose the income or work that children provide. Community facilities can often assist families with some of the tasks (especially domestic and home-farm tasks) that keep children out of school.

Ideally education should be made compulsory, and legislation to that effect be enforced, at least up to completed primary education, and preferably beyond. But such legislation is hollow unless parents can afford to lose their children's work and pay the costs of their education, and education of adequate quality and proximity is available.[47]

Some of the "demand" factors are social, cultural and religious. Dealing with these is often very difficult, but is sometimes possible at low cost. Making schools suitable for Muslim girls, for example, is not necessarily expensive. It has been found in some places that once this is done, girls even from quite poor families will attend.

Finally, quantity versus **quality** of services – closely related, as has just been seen to the supply-demand issue. The principal need in countries where primary education is of low quality is more non-teacher inputs: text-books, writing materials, blackboards, adequately furnished classrooms etc. Much of the decline in per pupil educational expenditure which has been associated with population growth has in fact fallen on these items; governments tend to protect teachers' employment (and that of educational bureaucrats) when budgets are hard pressed.

There is often no "trade-off" between quantity and quality: they are complementary. For example, it has been found in Brazil that improving the quality of primary education may require additional expenditure immediately but will eventually reduce costs per pupil because it will lower dropout and repeater rates.[48] *Higher quality commonly means higher quantity*. Such considerations have yet to be incorporated to any great extent into policy determination in many developing countries.

Quality issues in health services have been less studied than in education, but are similarly important. One area that has been studied is family planning services. Some of the pessimism about family planning in the 1970s and 80s has been due to the poor quality of services leading to low uptake, rather than lack of interest among couples – even if demand rather than supply has often been the main problem. This is true more generally of public health services, which may deter patients because of low quality or absence of supplies. A number of other features affect demand, such as distance and costs of travel, waiting times, the opportunity cost of time to the patient. The extent of spending by the poor on private health provision may be a measure of the inefficiency of public services.

Perhaps even more radical than in health and education are the changes in thinking about **skill development**.[49] Some years ago countries would have used manpower planning: forecasting exercises about output growth in specific sectors and products, and related occupational and skill requirements. These are now close to obsolete – even in the former centrally-planned economies, they were grossly inaccurate. (Perhaps "even" is the wrong word.) Manpower planning has been replaced by the use of labour market signals and other information.

Countries will vary in the extent of available information to determine priorities in skill development. Rate of return analyses, vacancy information, firm level surveys and other sources of data on skill shortages can be relatively abundant or scarce. Where deficient, firm-level surveys are among the most useful sources of data; they can be carried out relatively quickly, to yield information on occupations, education and training levels for specific sectors – including management education and training.

Similarly radical are changes in approaches to education and training for manufacturing and services development. Most training today is carried out by firms, but public policy can assist firm level training in a variety of ways, and often must do so, since it is an area where market failure is common. Vocational education is less emphasised, since it is often as far as industry is concerned an expensive way of doing the wrong thing – though it is still of considerable importance in rural education. Important choices for government are when to set up public training institutions: these can be valuable when there is a demand or clear future demand for specific skills, but for reasons of economies of scale or other considerations, the market does not produce them efficiently.[50] Good examples have been the targeting of information technology (IT) skills by Singapore, through a variety of public and private programmes; or the Clothing Industry Training Institute in Sri Lanka, which has helped that country to international competitiveness in garment exports, teaching skills specific to the modern trade in garments.

But governments should not be overactive in this area. Developing countries are littered with ineffective public training institutions, teaching skills for which there is little demand. They can however often be reformed to do a useful job, by such means as putting business people on their boards, or undertaking contract training for firms on demand. Experience of governments trying to promote IT training has also varied among countries, though there are lessons which have been learned and which can help to avoid future mistakes.[51]

A difficult issue is how to avoid "educated unemployment", i.e. producing skills for which there is insufficient demand. It is probably better to err on the side of excess rather than inadequate supply; but few countries – including the EAIEs – have avoided periods of over-supply. Some so-called educated un- or under-employment is illusory: there are people with paper qualifications not employed for the job they seem qualified for; but in reality their degree of qualification is exaggerated: the quality problem again.

What policies and priorities are likely to emerge from comprehensive examination of the various needs in education and health just described? It will usually be found, after the full range of information has been brought to bear, that *good quality primary education for all* will be an important goal. Most of the relationships between education, health, fertility decline and poverty alleviation lie in primary education. But there are difficult questions of phasing of the achievement of such a goal.

In part this is a question of cost: the last stages of universalisation of primary education are likely to be higher in cost, since they involve dealing with child labour, perhaps requiring compensating parents) and other difficult issues, and also with remote and scattered populations. (The returns to these measures may be lower than elsewhere.) In part, there may be conflicts with other educational priorities: particularly, from the point of view of skills development, secondary and adult education and selected parts of tertiary education and publicly supplied training. Where budgets are severely restricted, it may be that the needs of the productive economy must take some precedence – if greater dynamism can be imparted to development, growth will permit higher public expenditure on basic education in due course. Over-concentration on basic education at the expense of secondary education can also, paradoxically, have an inegalitarian result, creating educational elites.

One cannot leave a discussion of education giving the impression that everything is to be decided on purely economic grounds. Education serves important purposes in addition to the economic – they are national, social and cultural. Preserving a linguistic and cultural heritage is an important function, at the heart of society's values. Universal literacy and basic education help social integration. There are many difficult choices among objectives. But there is an overriding economic constraint – whatever choices are made, they have to be financially sustainable. It is for this reason that the present paper places so much emphasis on the productive objectives.

It is even harder to generalise about health than education: priorities differ from one setting to the next, given the incidence of ill-health and the state of existing health services. But in very many countries, health expenditures are very far from being efficiently distributed, in the sense of being allocated to uses with the greatest health improvement per unit of expenditure. This is always a basic guide, and would, in most developing countries, push health expenditures more towards primary health care and public and preventive measures, and less towards curative measures.

Finally, **the funding of human development**. Many countries have gone through an acute fiscal squeeze in recent years; and many countries have major distributional distortions in educational expenditure. Any human development strategy is likely to make increasing budgetary demands, and call for reallocation of public expenditure. Foreign assistance can contribute to the necessary finance, but countries will still in most cases be faced with finding more resources *and* taking decisions in favour of the poor which may be resisted by those whose benefits will be reduced. (In a large range of countries, 35-50 percent of the education budget is devoted to higher education, the beneficiaries of which represent a small fraction of the population, frequently the children of better-off families who have been able to pass successfully through the earlier levels of education. A combination of fee-charges and efficiency increases in higher education could often fund the bulk of expansion and improvement needed in the primary sector.)

Among the most fruitful sources of educational reform is the use of private financing and cost recovery in post-primary education. Whether primary education itself should be subject to fees, other than means-tested fees charged to better-off parents, is a more difficult question. Certainly where there is a risk that fees might discourage access, the benefit of the doubt should weigh in favour of free provision. Some countries – e.g. Kenya – have managed to extend secondary education with considerable contributions from parents. If means testing and cost recovery are impracticable, another technique which can be tried is that of education vouchers: schools charge fees, but (non-transferable) vouchers are given to poorer parents which the school collects for reimbursement by government. Failure to collect fees where practicable and equitable penalises the poor: it either reduces the level of services provided, or subsidises the better-off, or both. At the same time, care has to be taken that cost-recovery does not penalise the poor. The presumption that primary education at least should normally be free does not require, though, that *provision* has to be by the public sector.

Private provision of educational facilities and educational inputs has great scope. It no longer is, and certainly should not be, the reflex in most countries that if something is needed in education, the public sector should provide it. From schools themselves, and ancillary items such as text-book production or school construction, there are valuable and cost-reducing opportunities for the private sector, for NGOs and for local community participation.

At first sight it may be thought that there is an impossible task of priority determination, even within education, let alone among all the human development sectors. There are of course choices to be made. But in reality, in any given country, there are a variety of constraints, from manpower to finance. The feasible options are far fewer than the imaginable options. Normally one is pushing out the boundaries at the margin. It is over the long run that major change is possible; then what is important is that the directions of change and the vision that informs a new emphasis on human resources have the right goals. Establishing those goals, and working out an efficient and practical path towards them, may be the most important step.

One further feature in funding is to bear in mind that many outlays pay for themselves very quickly from the government's point of view. The example of improving quality in primary education was given above. Female education has been found to reduce costs in health and other services through improvements in health in India and Pakistan; successful family planning programmes have also been found to pay for themselves within a very few years in terms of reduced costs in health, education and other services.[52]

3

Policies for International Co-operation

3.1 Trends in Aid

What are the implications of the discussion thus far for international co-operation? The prospects for aid volumes are not all that clear. There is Congressional opposition to aid in the US, and appropriations for various purposes have been cut, even if so far by less than was once feared. At the same time, the largest donor, Japan, has reiterated its commitment to continued increases in aid; several other donors remain similarly committed, while yet others expect no change or modest declines. Insofar as aid is under threat in volume terms, it is mainly in the US that there is strong opposition on political grounds. In other countries where declines may be in prospect, it is more a result of pressure on public expenditure, and of governments either not wishing to raise taxation or feeling the need to curb public borrowing.

In addition, within aid budgets, there is growing pressure to allocate aid to short- rather than long-term development priorities. Bilateral aid for emergency relief and refugee assistance from members of the OECD Development Assistance Committee (DAC) rose from $1 billion in 1987 to $3.5 billion in 1994; including emergency food aid and contributions for emergencies to multilateral agencies, total emergency aid was about $6 billion, or some 10% of all aid in 1994; aid for developing country refugees alone took $2.5 billion. While total Official Development Assistance (ODA) rose from 1987-92, in 1993 it fell back to a level below that of 1991, but rose once more in 1994, to $59.2 billion. Total assistance for relief was just under 4% of ODA in 1987; its rise to 10% in 1994 thus removed 6% of ODA from longer-term purposes.[53]

While moderate declines in aid may not create difficulties for many aid recipients, they clearly can for the least developed countries and for much of Sub-Saharan Africa, where annual budgets, payments balances and capacity to service debt are often heavily reliant on aid. There are mixed prospects for aid to Africa: possible US cuts in its contributions to IDA and the African Development Fund (the African Development Bank's soft loan window) do not augur well. One or two donors cut their contributions to the 1994-96 Special Program of Assistance for Africa chaired by the World Bank, but Japan increased its input, and the overall funding level will remain marginally up if existing pledges hold. Some European donors (the UK among them), have cut their contributions to the European Development Fund (EDF) but have done so expressly because they are concerned about the effectiveness of EDF assistance, and will increase their bilateral funding with the amounts taken from the EDF. Overall, aid to Sub-Saharan Africa seems set to remain close to current levels, though there may well be closer scrutiny of countries not deemed to be making adequate efforts of reform.

Problems remain with international treatment of African debt. The G-7 Naples summit in 1994 made some new offers on bilateral debt, but with fairly tough performance conditions that will take time for countries to meet. A large proportion of several African countries' debt is multilateral and not currently open to rescheduling – 66% of Uganda's debt, for example. Further debt measures are desirable to get African countries out of the cycle of renegotiations. The proposals on multilateral debt put forward by the British Chancellor, Mr Kenneth Clark, at the Commonwealth Finance Ministers meeting in Malta in 1994 represent an important initiative.[54]

Even if aid for long-term development were not shrinking, making it more effective would be an imperative for donors and recipients; and it is all the more so in present circumstances. The question is, how might that be done?

3.2 Changing country allocations of aid

A natural response would be to think of changing the country allocation of aid. A significant proportion of aid goes to countries whose income levels are relatively high, and which cannot in many of the better-off cases be said to need aid by most criteria: they have reasonable payments balances and levels of foreign reserves and savings, are creditworthy for commercial borrowing, and are if anything only in need of a certain amount of technical assistance. If aid were reallocated from such countries to those where the usual economic criteria for aid apply, there would certainly be more to go around. On average for 1992-93, 20.3% of aid was allocated to lower-middle-income countries (per capita income \$676-\$2,695 in 1992), 2.6% to upper-middle-income countries (per capita income \$2,696-\$8,355), and 4% to high-income countries (per capita income above \$8,355).

There are, however, only limited prospects for any such changes at present. Where significant volumes of ODA are flowing to better-off countries, it is nearly always bilateral, and nearly always because of political or strategic motives on the part of the donors. In fact in recent years, the DAC has "graduated" a number of high-income developing countries, i.e. agreed to classify them as not aid-eligible, and taken a decision in the current year to examine more such cases. The DAC could not agree, as some donors wished, to lower the per capita income "threshold", for example to the IBRD graduation level (some \$4,000 plus), i.e. the point above which Part II members of the World Bank cease to be eligible for International Development Association (IDA) terms, which are highly concessional, and can only borrow on IBRD, only marginally concessional, terms.

The DAC did adopt a wider set of criteria for graduation including a variety of social and economic indicators in addition to per capita income; but these criteria will be employed on a case-by-case basis, and judgmentally, with no element of automaticity. It has been evident in discussions within the DAC that several donors have little desire to circumscribe their freedom to make ODA available to particular borrowers as they see fit.

In any case, it is not obvious that this is the right route. There are no apparent means that would command donor consensus of selecting significant numbers of recipients for graduation. Many would say, too, that the results of aid are sufficiently mixed that just giving a class of countries more aid, without changing its character, would not help much. The problems of deciding who to allocate the aid to would also remain. There is no real alternative to improving the effectiveness of aid.

Some reallocation of aid among countries will take place, for example, if IDA resources become more limited. Individual donors vary their bilateral aid levels overall and to particular recipients. But they have too many foreign policy and commercial reasons for aid-giving to make country re-allocation of aid on developmental grounds at all easy. It is hard to make a developmental case in China's current circumstances, for example, that it should receive large or indeed any IDA allocations, given its savings, reserves, and balance of payments position, and the huge inflows of FDI; but Japan, now IDA's biggest supporter, would currently resist any major change in China's share of IDA. It is only through the route of effectiveness that there may be a prospect of rechannelling of aid on a reasoned donor-wide basis.

3.3 Improving the effectiveness of aid[55]

Some broad issues

One key to improving effectiveness is understanding where aid has gone wrong – when it *has* gone wrong; one must always remind the aid pessimists that a large share of aid has been successful. Recent reviews of aid projects and structural adjustment lending make it starkly clear that one principle which should be high on the list for improving effectiveness is *recipient ownership of and commitment to* aid activities. Over and over again it is found that a critical aspect of unsuccessful aid operations is the lack of such ownership and commitment. It is true of structural adjustment policies, it is true of many projects, it is particularly and emphatically true in Technical Co-operation (TC).

Studies of aid effectiveness show that governments often attach low priority to TC, do not monitor TC activities centrally, do not have a separate record of TC; they appear to regard TC as a donor preoccupation, something they have to accept as almost the "price" of receiving the capital aid which they really want. TC is a prime example of aid which is often donor driven, and whose frequently poor record has much to do with that fact. The donors are now deeply concerned about this part of aid. Of course it is not all bad by any means and has a number of successes to its credit. Nevertheless TC is a quarter of all aid to Africa, and an even larger share of global aid, and both donors and recipients are right to be concerned. It is particularly important because the fate of *institutional development*, another key aspect of effectiveness, is intimately bound up with TC.[56]

Improving recipient ownership and commitment requires a number of things: more participation by recipients in the design of projects and programmes; greater efforts by donors to familiarise themselves with recipient conditions, social, political, institutional as well as economic; greater use of recipient expertise about development needs, possibilities and prospects. Policy reform under one-sided conditionality, expressing donor wishes and recipient acquiescence, is not policy dialogue. It is monologue plus money. It is unlikely to work.

One goal is the *sustainability* of aid activities. ("Sustainability" is used here to mean the capacity of aid activities to survive after the period of donor funding is complete.) Donors may well wonder what they have contributed to development if, a few years after their projects and programmes are complete as far as their financing is concerned, recipients abandon them. Studies of projects have shown a number of things to be important to sustainability: technology, which should be suitable to local conditions and the experience of local managers; administrative arrangements, which should strengthen rather than compete with national administrative structures; and accord with national priorities. Recipient ownership and commitment are affected by all of these.

It has also frequently been suggested that recipients should play a greater part in evaluation – suggested, but not much followed. A proposal has been put forward about TC in particular, that it should be subject to a combined process of *assessment, evaluation and identification, led by the recipient government*, or an agency such as UNDP in conjunction with the recipient. A national TC assessment would be prepared at regular intervals, and used as the basis for TC bids from donors; evaluation conducted within such a process would focus it on TC's developmental impact from the recipient's point of view. It could also be a basis for untying TC, a desirable goal, though one which is well-known to be difficult for donors to accept.[57]

The proposal has much in common with the suggestion that aid in general for individual countries be related to a "*Priority Investment Programme*", prepared by the recipient and agreed with the donors, which then becomes the basis for offers of aid. This was originally suggested by the World Bank as a co-ordination measure; but it would also serve to enhance the recipient's sense of ownership, as would the TC process just mentioned. A broader approach of this kind is currently under consideration in the Development Assistance Committee of the OECD. Making aid much more recipient centred is a high priority in the aid community.

A large factor on the recipient side accounting for poor aid performance has been the policy environment. There is hope for considerably improved aid performance in future as a result of the sweeping changes in developing countries' economic policies, which have come about through their own efforts and through the *structural adjustment programmes* led by the World Bank and International Monetary Fund.

In the context of macro-economic imbalances (e.g. high inflation, fiscal deficits, and balance of payments deficits), the Bank and the Fund deserve credit for assisting numerous countries to move towards a better policy stance. But credit is not all they deserve; they are also open to criticism. If some of the results of structural adjustment have been disappointing, part of the reason has been errors in their programmes, particularly in structural adjustment in Africa. While performance in some African countries is beginning to look more favourable, in several the economies are not yet responding to treatment (and some have not tried it at all consistently). There has been one overall failing of structural adjustment lending in Africa and elsewhere: the attempt to correct deep-seated problems in too short a time. The sources of this failing are numerous: some of them lie in the design of programmes, and include overestimation of the extent or speed of response of economic variables, or over-optimism about the pace and strength of institutional change. Some stem from the inflexibility of programmes, and the concentration on demand rather than supply measures – indeed, had the latter been more in evidence, it would have been even more obvious that the time needed for adjustment was much greater than assumed.

A list of more detailed troubles afflicting several programmes in the early years of adjustment would include the following: excessively exclusive reliance on reforms in prices and market signals without supporting measures of other kinds; insufficient attention to areas where greater public investment is needed (relative to reforms in the state sector); over-emphasis in financial reform on the views of the "financial repression" school, misplaced confidence in the effects of interest rate increases, and lack of appreciation of the realities of formal and informal financial markets and structures; lack of understanding of the prospects for privatization; undue reliance on, and over-optimism about the prospects for, traditional exports, and lack of attention to policies for expanding manufacturing enterprise and other non-traditional exports; insufficient attention to the fiscal consequences of devaluation packages; conflicts between short- and long-term policy requirements, perhaps most particularly in the field of *investment in human resources*; and inadequate efforts to protect the poor and public programmes beneficial to them from the consequences of reform.

Many of these mistakes in policy have been revised. Certainly there is much greater attention today to the needs of the poor under structural adjustment, even if policy has not yet gone far enough. The latest World Bank study of African adjustment speaks of "reforming financial reform", and admits that there has been excessive reliance in the past on "quick fixes". It admits that there were some fallacies of composition in the advocacy of expansion of traditional commodity exports: that supply expansion might have made sense for individual countries in some products, but not if several countries did so at once – what the study calls the "adding up problem" – and suggests some changes in trade adjustment policies, including supply-side measures. A new realism has dawned on the length of time that liberalising reforms will take, and on the importance, and intractability, of institutional reform and strengthening that is needed.[58]

The policy environment that prevailed prior to adjustment was by common consent inimical to development. The fundamental thrust of macro-economic reforms has been right, in the sense both of what required correction and of (many of) the measures introduced to achieve that correction. So have many of the more detailed reform measures. But in some areas the philosophy underlying reform, that getting prices right will solve most of the problems, has been exaggerated. Prices of course do have to be got right; but so must many other things besides, including things that have to be done by governments.

In the end, within structural adjustment, there are potential conflicts of priorities which have not been resolved. Arguably there has been, for example, excessive concentration in African agriculture under structural adjustment on the promotion of cash crops, rather than on smallholder agriculture and food crops. The latter require a range of policies and programmes beyond market reforms which have not adequately been attended to: research and extension, agricultural services and inputs including credit... The list is well known. They require in turn attention to institutions and governmental capacities, and a long-term involvement which has so far not characterised the adjustment process, indeed to which the reforms that have taken place so far are a prelude – a necessary one, but only a prelude. If productive capacity and improvement of the lot of the poor are the objectives of aid, these problems deserve far more attention than they have so far received. In this context, the new Consultative Group to Assist the Poorest (CGAP) launched in 1995 is a valuable start; the World Bank will contribute $30 million, and other donors possibly $70 million, to a fund intended to reach the poorest through institutional micro-finance programmes. However, the full range of necessary measures is considerably wider.[59]

Three inter-related topics stand out from the analysis of this paper: human development, governmental capacity, and the private sector. Discussion of the role of aid in these three areas closes the main paper. There is some concentration on Africa – it is no secret that aid has been less successful there than elsewhere. But the lessons of past aid experience have broad applicability.

Assisting human development

It has been argued above that human development must be a main concentration of the overall development effort – both as an ambition of development, and as an ingredient of the process. It has also been argued that several elements of it are paying propositions for government – current revenue costs are recouped fairly quickly by resulting savings. Funding for human development is not "welfare spending". The following are some of the means by which international co-operation can assist:

- Helping countries to *formulate HD strategies*. There is new expertise on human development but this needs to be tailored to a particular country's priorities and circumstances. Donors should be ready to help mount studies leading to new HD strategies, taking account of both humanitarian and productive objectives. Local experts should play major parts in such work, supplemented as necessary by overseas personnel.
- Assisting *skill development*. This needs *much* greater priority in HD strategies.[60] While basic health and education for all should become universal, phasing the approach to universality must take account of costs, and the competing claims of skill development. Establishing priorities here, and policies to encourage firm-level training, are part of strategy formulation; they may also suggest roles for TC. Donors can also support free-standing training institutions where these are appropriate.
- Assisting *financing* of HD. The most general means is for donors to fund a "time-slice" of a particular ministry's work, or selected programmes within it, i.e. to finance a share of annual capital and recurrent expenditures for a period of two to three years, after satisfying itself that it is in accord with the country's policies. Progression has to be built in so that the donor's funding would gradually be replaced by the recipient's. Donors can also assist with promoting private sector and NGO provision of services, with voucher schemes, with community-based services, and so forth.

- *Getting user fees right.* An important part of financing today is user fees or charges. This field deserves greater care than has sometimes been exercised. While fees can properly be used to recover costs from those who can afford to pay them, they have sometimes been introduced without appropriate knowledge. It is essential that any charges introduced should not damage the interests of the poor. Some introduction of user fees has undoubtedly created hardship. At the same time, if governments are strapped for cash, the alternative to charges may be reduced services. Difficult choices have to be made: but at least they should be informed choices.

- Assisting *commitment.* Donors can and do assist countries in building constituencies for policy change. This may be particularly important when reallocation of existing patterns of expenditure is necessary, but interest groups resist.[61]

- Assisting with *new technology* development and *new approaches.* New techniques of distance learning, methods of setting up "open universities", new learning methods including the use of computers, new methods of text-book production; new health technologies; new approaches towards population, combining maternal and child health and family planning, and relating to other HD programmes, especially female education.

- Assisting management and the heightening of *efficiency* in public sector programmes. This has much to do with the improvement of governance – *see* below.

- Greater *donor co-ordination and complementarity.* A number of donor agencies have announced major increases in future funding for HD. But each agency has strengths and weaknesses in what it can and will do. More and more efforts to fund HD without better co-ordination may yield disappointing results. Ideally donors would join forces with each recipient in designing an HD strategy, and would then co-ordinate assistance with appropriate division of labour among themselves.

Strengthening governmental capacity

Many developing countries lack effective government and administration, and as a consequence development policies and their implementation leave much to be desired. There are also problems of transparency and accountability in some countries, even questions about the commitment of government to development itself. Without more effective government, many countries will not achieve their development. The private sector is not a substitute for good government and the efficient management of resources; in its earlier stages, it needs good government to become established. Provided donors wish to help movement to change in more promising directions, there are a number of things they can do:

- *Assist civil service reform,* which usually requires downsizing, and improving the quality and conditions of service of personnel. The civil service must also be permitted greater roles in policy formulation, and often needs greater expertise especially in areas of macro-economic policy. Taxation policy and its implementation are also important areas for donor support.

- *Assist the emergence of transparency and accountability.* Civil service reform and support for the judiciary, the legislature and, independent media can help in this direction. Public debate about development and its policies, and engendering national consensus about priorities are important to the process. So too are certain technical capacities – donors can support the legal, accounting and auditing professions, which are often weak. Greater transparency in aid procedures on the donors' part and their opening to public scrutiny would also be helpful.

- *Assist domestic capacity building.* Aid can help in training key decision makers as well as independent academics and researchers who can ensure a continuing personal and intellectual interchange on policy and public matters. The "brain-drain" of capable people from developing countries is not by any means solely due to the attraction of higher pay abroad. Many migrants would rather stay at home if they could make a contribution to national development – but that often requires that they be free to criticise as well as co-operate, without risk to their livelihoods.

The most difficult questions surround the issue of political conditionality. While democratic institutions can be valuable for building support for the "developmental state", and safeguarding civil institutions which promote transparency and accountability,[62] the experience of political conditionality has been mixed. It can backfire, and stiffen internal resistance to democratisation; or democratic institutions can be set up, and abused by demagogic politicians. It can also be positive – there have certainly been cases where threats to withdraw aid have assisted the move to helpful political reforms.

Donors are most likely to trespass onto unsafe ground if they try to specify the *form* of democratisation they favour; they are least open to criticism when they press for support for the institutions of civil society. In between these ends of the spectrum, donors have to exercise the most sophisticated judgment.

Discussion of these questions often transfers to that of "*need versus performance*" in aid allocation. Should donors give aid to those who need it most, or to those who make the best use of it? It is an old debate, but perhaps it sets the frame in the wrong place. There is not much point in giving aid where it will not be effectively used; and countries which make the best use of aid may be the ones who least need it. Surely the way through this maze is to apply criteria of both need and performance productively. Where governmental performance is poor while need is great, aid should be concentrated on improving that performance, and otherwise devoted to channels that depend less on government – NGOs and the private sector.

Performance can also be rewarded: and perhaps better retrospectively than prospectively. Many performance conditions are attached to loans already, but donors often find it difficult to curtail lending when the conditions are not fulfilled. They are involved in a complex relationship, and have to make fine judgments about whether on balance it is better to persevere with it or not. While these kinds of conditionality are inevitable – though it has been argued above that they would be more successful if they had more recipient support – donors might find it more effective to let recipients know that their progress is being monitored, and that signs of continuing good performance in specified respects (macro management, particular programmes) will be rewarded by future allocations, or poor performance (such as excessive pipelines of unspent aid) penalised.[63]

Strengthening the private sector

Many of the above functions of aid are important to the development of private activity, which must be one of the mainsprings of growth. Most donor countries have agencies supported by aid ministries which assist the private sector directly – the UK's Commonwealth Development Corporation (CDC) and its opposite numbers. Some of these agencies – not least those of Canada and the Nordic countries – have had valuable experience in aiding SMEs. Their experience could be more widely shared among themselves and with recipients. One of the keys to helping SMEs is finding the appropriate financial intermediary. But as noted earlier, funding is not the only problem: providing technical support may be at least equally important, and here East Asian, and perhaps particularly Taiwanese, rather than donor experience may be the most valuable.

While things have improved somewhat in donor sharing of the lessons of aid, not least because of efforts of the DAC, it is still true that donor agencies are more efficient in using the feedback from their own activities than from each other's. Donors have also had very mixed experiences with financing recipient development banks or Development Finance Corporations (DFCs) which on-lend to the private sector – often because they have neither been good at project selection nor "tough" in applying commercial criteria for lending; often too, not uncommon as the background to the last point, DFCs have been under political rather than strictly economic direction.

These are among the old instruments for private sector support. There are others. Public sector infrastructure and other projects and programmes can support the private sector. USAID successfully used a large road project in Thailand to foster the coming into being of a private sector construction industry by insisting that roads should not be built by the Public Works Department, but tendered for privately. Given that much aid will still flow to the public sector, this type of example can be more widely followed, including, as was noted above, some parts of health and education services.

The newer instruments include measures such as the Commonwealth Private Investment Initiative (CPII), under which the CDC as the manager of the CPII will invest in expanding privatised or privatising companies and SMEs across all sectors, emphasising the creation of new assets and the introduction of improved technology. New means have also to be found to combat what is proving to be a growing problem in several privatisation programmes, namely political objection to the character of the new ownership, be it foreign, or a domestic minority or other group. Countries are experimenting with unit trusts and other methods of creating ownership structures which permit wider participation in share-holding.

A valuable new study by the Overseas Development Council (Washington DC) of potential expanded roles for the World Bank in private sector support recommends four major new initiatives:[64]

- *A new operating unit within the International Finance Corporation (IFC) for project development promotion.* This should have the task of "project development promotion and investment in countries less advanced in private sector development that do not have market access to private financing". This would be a more entrepreneurial function than the IFC has mostly been used to, and would have to include the cultivation of entrepreneurship and management in the host country. It would take the IFC into countries that it has largely neglected, or felt obliged to neglect, and bring much-needed private investment to them.
- *A heightened role for the IFC as the private sector partner for the World Bank group.* The study argues that private sector knowledge and experience, and understanding of private sector activities in borrowing countries, is very thin within the Bank except in the IFC. The whole of Bank/IDA operations need to be more pervasively suffused with this knowledge and experience; a variety of managerial and organisational options are discussed for the purpose.
- *An expanded programme of intermediary financing.* This is not a return to the old DFCs, but an initiative to support the development of financial intermediaries, with capacities for project analysis and promotion, for on-lending, and for encouraging equity participation in the underlying investment projects. As the study argues, financial development is a slow process, especially in the less advanced countries; this kind of support for financial

intermediation should be part of the process, and will accelerate one of the main purposes of financial reform.

❖ "*Mainstreaming of guarantees*". This has been the subject of a Bank paper, elaborated by the study. The proposal is to extend the Bank's guarantee capacity to portfolio investors and banks for public sector infrastructure financing, principally through the Multilateral Investment Guarantee Agency (MIGA), including partial guarantees, or performance guarantees (such as guarantees against breach of contract). Borrowing governments would make reciprocal guarantees of their contractual obligations. The essential aim of the initiative is to widen the range of countries given access to guarantee facilities.

The study emphasises that these initiatives, in the case of the first three, have implications for the staffing and "culture" of the Bank and IFC, and in the case of the second, to its operating principles. As with most fields of aid, improving support for the private sector is the subject of a wealth of writing and research – the main need is to bring this knowledge together and have it acted on. But the above four proposals are relatively new and creative, and deserve consideration.

A last word

Ultimately the aim of aid must be to become unnecessary. As more and more countries acquire the capacity to achieve their development without concessional borrowing, aid can concentrate on the remaining countries with the most difficult problems. For developing countries, the chief implication of limited aid is that they will have to do better themselves. Aid is of course not the most important external factor, and developing countries look to the industrial world for better trade and financial conditions in addition to aid. But if aid shortages concentrate both donors' and recipients' thinking on how to strengthen indigenous capacities for development, that would not be such a bad outcome.

Notes

1 All figures in the text are from World Bank data as cited in the *World Development Report World Tables*, various years, unless otherwise indicated. There are numerous studies of the East Asian countries: *see* e.g. Amsden (1989); Fishlow *et al.* (1994); Grossman (1990); Ito and Krueger (1995); Lall (1995); Pack and Westphal (1986); Wade (1990); World Bank (1993a).

2 *See* e.g. Alesina and Perotti (1994); Persson and Tabellini (1994).

3 A. Young (1995); Krugman (1995).

4 Rodrik (1995).

5 Lee (1995); World Bank (1993a).

6 Kwon (1994). Wade, in Fishlow et al. (1994), has also argued that World Bank (1993a) wrongly identified the promoted and not-promoted sectors.

7 Dollar (1992).

8 Nam (1995).

9 Inflation figures are annual growth of Consumer Price Indices. The 20% "upper limit to manageable inflation" is discussed in Dornbusch and Fischer (1993).

10 For studies of the importance to growth of managing shocks, *see* Helleiner (1994). For a valuable experience relating stability, shocks and market development in Uganda, *see* Tumusiime-Mutebile and Henstridge (1995).

11 On savings and the financial sector in East Asian economies, *see* World Bank (1993a).

12 For a brief review and references on the theory and experience of financial repression and liberalisation, *see* Montiel (1995).

13 The author is grateful to Valpy Fitzgerald for these points; he and Ajit Singh made valuable related comments at the Round Table in the Commonwealth Secretariat on January 25, 1996.

14 Further thoughts on Asian lessons for Africa can be found in Stein (1995). For an account of some of the salutary experiences which helped to form attitudes on "picking winners" in the UK, *see* Henderson (1985).

15 On the new growth theory, *see* Barro (1991); Lucas (1988); Romer (1994).

16 Detailed estimates of the contributions of human capital to growth and productivity in East Asian countries are given in World Bank (1993a); the citations are from pp 53-54 of that study.

17 On educational costs in Asia, and demographic aspects more universally, *see* respectively Tan and Mingat (1992), and Cassen and Contributors (1994). Further elaboration of the "virtuous circles" can be found in Birdsall and Sabot (1994).

18 Data are from World Bank (1993a).

19 *See* Ogawa *et al.* (1993), and World Bank (1993a).

20 Japan's Overseas Economic Co-operation Fund (OECF) and the World Bank organised a symposium on the *East Asian Miracle* study in Tokyo in December 1993, whose proceedings were published in OECF (1994a); an issue of the OECF *Research Observer* was also devoted to the study (OECF 1994b). In both, Japanese and other scholars assessed the Bank's study, most of them critically on these central questions. There have been numerous contributions to the debate, few of them – except those emanating from the World Bank itself – supporting the Bank's line. *See*, for example, Fishlow *et al.* (*op.cit.*). Recently the World Bank's Chief Economist has foreshadowed a possibly more nuanced approach by the Bank -*see* Bruno (1995).

21 For a study of the implications of the WTO and the Uruguay Round generally *see* Commonwealth Secretariat (1995a).

22 *See* IDS (1996). These considerations apply particularly to Sub-Saharan Africa, but also Latin America, where there is often particularly intense poverty and mal-distribution of assets.

23 On the relations between growth and poverty, *see* World Bank (1990a). Poverty also increases with recession.

24 *See* Chhibber *et al.* (1992).

25 The citations in this and the next two paragraphs are from Lipumba (1994), pp 79, 85 and 89 respectively.

26 Two valuable reports on employment appeared in 1995, ILO (1995) and World Bank (1995b). They both cite extensive literatures, some of which have also been drawn on in these paragraphs.

27 MNC-related employment figures are from World Bank (1995b), p 62.

28 The curve relating life expectancy and per capita income also shifts upwards over time, presumed to be the result of medical advances – *see* Preston (1980).

29 Caldwell (1986).

30 Schultz (1987).

31 For further details on these topics, *see* Lloyd (1994).

32 Dasgupta (1993).

33 "Unwanted fertility" is measured in fertility surveys. For a description of the technique, *see* Bongaarts (1990); and for a critique, *see* Dixon-Mueller and Germain (1992).

34 Jejeebhoy (1993).

35 Kelley (1994). The finding is not worth all that much, as the author himself observes – no such relationship was found for the 1960s or the 1970s, casting doubt on its meaning in the 1980s. The finding for the 1980s is however, robust, and not explained either by low income growth in Africa which may be due to other factors, or by any terms of trade effect on income growth internationally.

36 *See* Cochrane (1986 and 1988).

37 Pollitt (1989) surveys the field.

38 Alderman and Garcia (1994). The finding that food deficiency is by no means the common explanation for malnutrition is widespread; even where food availability is adequate, infection and disease can severely reduce its contribution to physical development. For a detailed discussion of the relations between income and nutrition, *see* Payne and Lipton (1994), especially pp. 96 ff.

39 Martorell (1986); Martorell and Habicht (1986): Selowsky (1980); M.E. Young (1994).

40 R. Fogel (1994), cited in Rosenberg (1994).

41 Barro (1991).

42 Ogawa *et al.* (1993); World Bank (1993a).

43 The World Bank's "East Asian Miracle" study emphasises the role of human resources in these economies' success (World Bank, 1993a); Dertouzos *et al.* (1989) analyze US failings in this regard.

44 For a reassessment of rates of return in education *see* Bennell (1994); for the investment view, *see* Psacharopoulos (1993).

45 The private health expenditure estimate for India is from Berman (1995); on African health facilities and NGOs, *see* Fisher (1993), esp. pp. 128-33.

46 For a study comparing the effectiveness of private and public education, *see* Kingdon (1994) – this work surveys a large literature on a variety of countries.

47 *See* Weiner and Noman (1995); and Bequele and Boyden (1988).

48 Harbison and Hanushek (1992).

49 This section draws extensively on Cassen and Wignaraja (1996).

50 *See* Godfrey (1993). More generally *see* Middleton *et al.* (1993).

51 The December 1992 issue of *World Development* is devoted to IT in developing countries, and has, in addition to positive stories, some salutary lessons from experiences of introducing IT in Africa. The Sri Lankan institute is described in Wignaraja (1996). For an example of poor performance, *see* World Bank (1990b).

52 For the effects attributed to female education in India and Pakistan, *see* World Bank (1995c). There have also been cases where failure to spend relatively small sums has been extremely expensive – spectacularly so in the 1991 cholera epidemic in Peru. In this somewhat extreme but easily repeatable case, the losses to Peru of agricultural exports and tourism earnings in the first ten weeks of the epidemic were estimated at three times the entire amount invested by the country in water and sanitation during the whole of the 1980s – *see* World Bank (1993b). A similar estimate may one day be available for India, where losses of the same type were caused by an outbreak in 1994 announced as "pneumonic plague", though later shown to have been a less terrifying disease. The outbreak would have been avoided by modest expenditures on urban sanitation.

53 All aid figures are from OECD (1996).

54 Some of this background is from UN (1995). The Clarke proposals are described in Commonwealth Secretariat (1995b).

55 This discussion has drawn on, but goes beyond, Cassen and Associates (1994).

56 On TC, *see* Berg (1993); Cassen *et al.* (1990); Colclough (1991); and Forss *et al.* (1990).

57 The suggestion on TC is owed to Colclough *op.cit.*, but supported by the findings of the other authors just cited.

58 The World Bank report referred to is World Bank (1993c). For a thoughtful critique of it, *see* Lipumba *op.cit.* More broadly on structural adjustment there is a huge literature, much of it surveyed in Cassen and Wignaraja (1996). *See* also a series of country studies carried out by the OECD Development Centre, summarised in Morrisson (1992).

59 *See* IDS, *op.cit.*; and Lipton (1996).

60 Mensah (1995) makes a strong case on the neglect of skill development for Africa.

61 A good example of aid to help commitment was provided by the World Bank in Senegal, which produced a study showing the high level of resources absorbed by the university there with modest results, and then funded a national debate led by the government, which created a climate of opinion for reform. Donors can also fund community- and NGO-based activities to gain support for new policies and activities.

62 *See* Lipumba *op.cit.*; and Van de Walle (1995), summarising an extensive literature.

63 Formally, it would be possible to derive a composite index combining need and performance, and use it to allocate aid. But considerable research would be needed to explore the formula itself and the implications of using it; seeking consensus on its use could also be difficult.

64 Richardson and Haralz (1995).

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Appendix

Commonwealth Round Table on Growth and Poverty Alleviation in East Asia and other LDCs

A Note on the Commonwealth Round Table

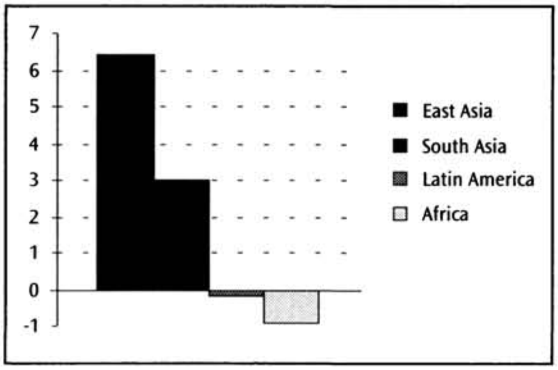
Mr. Ivan Mbirimi and Dr. Ganeshan Wignaraja, Commonwealth Secretariat

A round table conference was held in London on 25 January 1996 to discuss Professor Cassen's paper on "Strategies for Growth and Poverty Alleviation" and to examine whether East Asia's development experience could be replicated by other developing countries. The round table involved senior Commonwealth Secretariat staff and experts from the Universities of Oxford, Cambridge, Sussex, the London School of Economics, the Overseas Development Institute and the British Cabinet Office (*see* the list of participants below). It was chaired by Sir Humphrey Maud, the Deputy Secretary-General (Economic & Social Affairs) of the Secretariat. The agenda included an introduction to the issues by Mr. Rumman Faruqi, Director of the Economic Affairs Division of the Secretariat; keynote presentations by Professor Robert Cassen and Dr. Sanjaya Lall of Oxford University and Professor John Toye of Sussex University; and a discussion between the participants. The main points from the presentations and the discussion can be briefly considered under three headings: (1) East Asia's economic success; (2) ingredients in East Asia's success; and (3) lessons for Africa.

East Asia's Economic Success

The round table noted that the rise of the four East Asian "dragons" (Korea, Taiwan, Singapore and Hong Kong) is a spectacular post-war development achievement. Within a quarter of a century, each economy transformed from a subsistence trading and agricultural base into an industrial powerhouse. In the 1980s East Asia emerged as the best performer in the developing world in terms of rapid per capita income growth (*see* chart 1), sustained industrial deepening and diversification and a dramatic increase in living standards. The round table emphasised that today, these economies are competing overseas with the likes of Japan, the US and the UK. It was also emphasised that success in per capita income growth and poverty reduction in the first tier dragons has spilt over into a second tier of East Asian dragons (Malaysia, Thailand and Indonesia) but slow progress on both counts has been recorded in other developing regions. Africa's weak performance in the 1980s and 1990s was mentioned as a cause for concern in international policy circles.

Chart 1 **Per Capita Income Growth in LDCs, (% p.a) 1980-93**



Ingredients in East Asia's Success

The round table noted that there is little agreement in policy circles on the factors which underlie East Asia's success and there is even less agreement on whether this experience can be replicated in Africa. In an attempt to build a consensus on these issues, the round table examined opposing viewpoints. The round table recognised that East Asia was fortunate to have good initial conditions for rapid development such as a booming world economy, a close proximity to the expanding Japanese market, substantial international trading experience and large inflows of foreign aid. While acknowledging the contribution of these factors, the round table concluded that a major explanation for East Asia's performance was the adoption of a coherent strategy for growth and poverty alleviation in the early 1960s that was sustained to date. Box 1 shows the six ingredients in East Asia's common strategy.

Lessons for Africa

There was a consensus among round table participants that the inward-oriented development strategies pursued by African countries in the past had failed to deliver sustained growth and poverty reduction. Amongst other things, Africa's inward-oriented strategies resulted in poor per capita growth, declining industrial and agricultural growth, a sluggish export sector and a tendency for income distribution to concentrate. Round table participants also felt that several aspects of East Asia's development strategy, adapted to different initial conditions and historical circumstances, were relevant to African countries.

- First is a strong commitment to achieving **macro-economic stability and rapid growth**. Macro-economic management should be geared towards high savings and investment rates, low budget deficits and moderate inflation rates. Macro-economic stability and rapid growth are fundamental influences on private sector expansion, employment creation and poverty reduction.

- Second is the encouragement of **domestic savings**. Amongst other things, this may require agrarian reform, investments in human capital and use of corporate fiscal incentives to encourage the growth of corporate profits and savings.

- Third is the adoption of an outward-looking **industrial strategy**. The catalytic role played by foreign investment – in accessing capital, technology and marketing-know-how – to drive industrialisation in Africa is widely recognised. So too is the need to formulate the relevant promotion policies and soft infrastructure to attract foreign investment into the industrial and service sectors in Africa. Far more controversial, however, is industrial policy for domestic industry. The use of selective industrial policies practised in East Asia may be more difficult in the 1990s given the move towards global economic liberalisation embodied in the Uruguay round and the creation of the World Trade Organisation which is less tolerant of protection and subsidisation of industry. The success of selective policies also depends on the government's ability to collect, monitor and analyse information – such a capacity may be weak in several African countries. In this context, a gradual but credible approach to trade liberalisation with a strong export push may be appropriate.

- Fourth is **investments in human capital**. With a few exceptions, education enrolment rates at all levels are low across Africa, firm-level training is limited to a few large enterprises and governmental capacity to monitor and analyse information is weak. The creation of appropriate skills in industry and government is thus a vital precondition for sustainable development in Africa.

- Fifth is **the creation of technology institutions**. In view of low levels of technological capabilities in African manufacturing, there is an urgent need to

Box 1:

Elements in East Asia's Success

- **A stable, predictable macro-economic environment**
  Budget deficits were kept low, inflation was tightly controlled, a competitive real exchange rate was maintained and debt crises were avoided – in order to encourage savings and investment and rapid growth.

- **Encouragement of domestic savings**
  These countries achieved impressive rates of savings and investment by historical standards. Good initial conditions (i.e., land reform and thus relatively equal income distribution and favourable human capital due to educational investments) stimulated the growth of savings and investment. However, growth of corporate profits and savings were the crucial element in the rapid increase in domestic savings. In turn, corporate fiscal incentives were widely used to promote growth of corporate profits.

- **Selective outward-oriented industrial policies**
  Moderate infant industry protection and an aggressive export push were employed to create competitiveness and force domestic firms into overseas markets. As industries matured and entered export markets, new industries were promoted. Foreign investment was selectively targeted through a combination of promotion and a comprehensive set of soft infrastructure policies (particularly, specialised technical skills, technological institutions, export marketing agents and other business services). The emphasis given to "creating winners", of course, differed between individual countries – Hong Kong was the least interventionist, Singapore in between, and Korea and Taiwan were the most interventionist.

- **Investments in human capital**
  As early as the mid-1960s, these countries achieved almost universal primary enrolment; one third secondary enrolment; and their tertiary enrolment, particularly in science and engineering subjects, were the highest in the developing world. There was also a strong emphasis on vocational training and the creation of industry-specific training institutions.

- **Creation of a comprehensive network of technology institutions**
  To upgrade production skills in manufacturing pertaining to improving process quality, productivity and new product development. Industry-specific technological institutions were also created to lower barriers to entry in high-technology industries and extension services were used to encourage small and medium enterprises.

- **Programmes to reduce poverty**
  These countries emphasised health care, education, land reform, a green revolution in agriculture and financial support for micro-enterprises.

boost quality awareness, productivity improvement and the creation of new products for export. Existing technology institutions may need to be reformed and new institutions may need to be established to deal with these issues. The establishment of private sector providers of technology import services needs to be encouraged.

- Sixth is a **programme to develop the agricultural sector and reduce poverty.** Rural poverty in Africa is widespread and an agriculture-led development policy (incorporating land reform, technological change and micro-finance) is a valuable supplement to poverty reduction through rapid growth. Development of the agricultural sector and processed primary exports in many African countries will in turn provide inputs for industrial development in the form of surplus labour, capital for investment, foreign exchange and a market for industrial goods.

In the final analysis, the round table felt that individual African countries may need to re-examine their own experience in the light of East Asian development practise and draw relevant lessons. In doing so, they should set realistic objectives for long-run development and maintain a consistent strategy. African countries should also bear in mind changed global economic circumstances in the 1990s and the limitations that they impose on national economic policy.

Opening presentation

Professor Robert Cassen, Queen Elizabeth House and St Antony's College, University of Oxford

The East Asian countries have drawn attention because of their successful transformation. Korea's per capita income was $325 in 1960, and is about $8,000 today. How did they do it, and can other countries follow their example?

Some of the means they employed were fairly conventional: paying attention to the macroeconomic fundamentals was one: low domestic and foreign deficits; competitive exchange rates; for the most part, low inflation rates, and high rates of investment in both physical and human capital; and, usually, positive real rates of interest. But some of their methods were *not* in line with current orthodoxies: public ownership of banks, directed and often subsidized credit; selective import protection; and a range of government measures to accelerate technological capability and promote exports, as well as, in some cases at least, a good deal of government guidance or influence on investments by private and foreign companies.

Whether other countries can follow in their footsteps is an open question. The Uruguay Round certainly provides opportunities. But the WTO restricts some of the export promotion methods used in East Asia: Bank/Fund structural adjustment programmes have tended to insist on import liberalisation, ignoring arguments for selective protection. Besides, there may not be room for any large number of countries to expand exports of manufactures on the East Asian scale. They will also have to target exports of services and agricultural commodities.

Finally, it must be said that other countries have tried some of the measures the East Asians used without obtaining the same results. East Asian governments, when they interfered with market principles, nevertheless subjected private sector companies to market tests. Profitability and export success had to be achieved, or privileges were withdrawn. These are things other countries have mostly *not* done when they followed interventionist policies.

As the paper puts it, the essential conditions for doing what the East Asians did included the capacity to sustain a stable macro and policy environment over long periods; a well-trained and effective bureaucracy; and the political conditions which ensured that public policy served economic and not partisan political goals.

The paper reaches two conclusions: there is much to learn from the East Asian experience, and countries can certainly adapt some of their methods to their own circumstances and make use of them. And secondly that any country can be inspired by their example, and move away from poverty and lack of development in a few decades, largely by their own efforts. We may hope that the new emphases in economic policy in a large number of countries may already have begun this process. But if we are looking for areas to apply the lessons, I might single out, first, examining carefully the implications of the WTO and Bank/Fund structural adjustment for exporting and other aspects of the East Asian story; and second, ways of providing technological support as these countries have done, particularly to small and medium enterprises.

Strategies for Growth and Poverty Alleviation

Clearly what has been learned from East Asia is important for promoting growth in general. Getting the macro-fundamentals "right" is one of the keys. A recent research finding is that the capacity to cope with exogenous shocks is crucial for growth; countries with high deficits and inflation in normal times will not be able to manage shocks; nor will they have the stable economic climate which attracts investors. Otherwise, the key engines of growth in the 20th century, in addition to exporting, have been the private sector and technology.

The paper notes that while many countries have introduced liberalising reforms, private investment has been slow to pick up. This is partly because of the retrenchment which has commonly accompanied reforms, but partly also because it takes as much as five years for investors to become confident that the policies and conditions for investment are there to stay. The more pervasive the pre-reform constraints on the private sector, the harder it is to move forward. In the enthusiasm for market reforms, it should not be forgotten how important governments are for creating the infrastructure and institutions that permit the private sector to flourish. For several countries, strengthening governmental capacities will be crucial. Just to give an example, it is government that leads the privatization process. (And here I might emphasize something the paper raises and which a number of Commonwealth countries have found to be important, that is, measures to attract widespread participation in shareholding and overcome some of the political difficulties of privatization.)

Apart from purchasing **technology** from abroad and developing it domestically, the principal sources of new technology are from investments by foreign firms, and from supplier-relations with foreign buyers in exporting. A great deal can be done to give support to technological development for large, medium and small firms by following best practice elsewhere, and the paper refers to this. Part of this development also depends on education and training, to which I come in a moment.

Growth does not automatically generate high levels of **employment**, the second part of an anti-poverty strategy. There are numerous lessons from employment experience. For many countries, agriculture must remain a significant source of employment; doing better in this respect often means removing the obstacles which have inhibited agricultural growth in the past, and eliminating subsidies to inputs – electricity for example – which substitute for labour. Encouraging small and medium scale enterprises, and better approaches to rural credit and micro-finance, are also important ingredients.

Labour-market factors matter too. In general research does not find that repressing union activity and labour has played a positive part in employment. What has been negative have been attempts to improve job security and conditions by measures which discourage firms from hiring labour.

Last but far from least, **human development**. A large range of evidence has begun to show how important health and education have been for economic growth. A major emphasis of the paper is that financial authorities should not think of these sectors as 'welfare', or as satisfying primarily humanitarian concerns. They do of course have that role. But they can also be highly productive investments. Many public expenditures in health and education will be recouped quickly by governments through reduced demands on services in the fairly short term. It is hard for countries to shift out of exporting primary products and into manufacturing without a strong base in human resources. Foreign direct investment today is increasingly attracted by low-cost **skilled** labour, not low-cost labour as such. In fact, provided other economic circumstances are moving in the right direction, human development can itself be an "engine of growth".

International Co-operation

Lastly the paper turns to international co-operation. If aid for long-term development is going to continue to shrink, it is all the more important that it concentrate on measures to make it more effective in contributing to the growth, employment and human development policies which the paper describes as the three pillars of an anti-poverty strategy. The specific measures are spelled out in the paper, and listed succinctly on the last page of the Executive Summary, and I will not rehearse them now. I am sure colleagues are keen to get on with the discussion. I will only add that donors and recipients alike are concerned about the performance of aid, especially, in some countries, increasing dependency on aid rather than increasing capacities to develop without it. If shrinking aid makes for concentration on how to redress this state of affairs, higher effectiveness may compensate for lesser quantity.

Comment by Prof John Toye

Institute of Development Studies, Sussex

I find it difficult to put a markedly different spin on the ball, because the paper which Robert wrote is very excellent in many ways. It is a very comprehensive paper and it covers a lot of ground. I think of it as almost an encyclopaedia of what one might want to know in this area. And it manages to be encyclopaedic at the same time as being very concise. But since the discussant's job is to put a different spin on the ball, I went through the paper very carefully, looking for propositions with which I could disagree. I have to say that I found hardly any propositions with which I disagreed. The paper is excellent both as a synthesis of academic wisdom on these questions and also as a very helpful guide to the relevant literature, so that those who want to follow up particular points can get into that literature. It also contains a number of interesting ideas about the question of what can be done in learning the lessons of the East Asian experience. So what can I do? I felt that what we have here is a canvas filled with a large number of small dots of truth. I propose to join up some of the dots in my own way and so draw my own picture. Relying rather heavily on Robert's paper, I am going to give some slight differences of emphasis, some areas of light and shade in this. On the whole, my spin is a little bit more pessimistic than what we have heard from Robert, both in the paper and his comments this morning. I apologise for that, but I must say what I think is right.

One part of the paper that I would pull out for special emphasis is the rather brief section – "Japan: a note". It seems to me that Japan needs much more than just a note. I see the East Asian miracle not exactly in the way that Robert has done. I don't find the Hong Kong or Singapore experience particularly relevant to the question of how other developing countries can go forward. They are rather special cases of small city states which you would expect to be doing a lot of exporting and to be well in touch with international currents through trade and other mechanisms. While it is interesting to hear about them, they are not the heart of the East Asian miracle.

I also disagree with the term 'miracle'. I don't disagree that there has been an extraordinary growth in the way that Robert has said. The facts are there but whether it is a miracle, i.e. something which cannot be explained by normal means of explanation, I doubt. My explanation would put Japan very much at the heart of this experience and the countries that I would focus on are Japan itself, Korea and Taiwan but also the coming third tier of Indonesia, Malaysia and Thailand. There are various ways of describing the dynamics of this experience and various metaphors have been used. The Japanese described it as the 'flying geese pattern'. This is a process whereby, having modernised the Japanese economy, a structured transition takes place within the neighbouring area. Japanese industries which have been superseded in the modernising process are decanted in a co-operative way to neighbouring countries. I have just been reading a fascinating book on this by Dennis McNamara who describes the process by which over the last 25 years the Japanese textile industry has been deliberately wound down and transferred through various mechanisms to neighbouring countries. This is part of a deliberate process, which the Japanese are quite clear about, and which has enormously benefited their neighbours in terms of a continuing self-reinforcing dynamism of growth in the area.

But there is no Asian model, which applies to all the growing countries of the region. All of these experiences are different from one another and Robert brought out in this paper some of the differences. The difference is marked between the use of the very small number of large corporations in Korea and the small enterprise focus of development in Taiwan. But there are other models in the third tier as technology, investment, orders and sub-contracting, cascade down to the third tier of countries. So there is no one model. What there is, is a dynamic process which can be called 'flying geese', or 'cascading' or whatever. If that is the case then that seems to me to reduce further one's estimate of the possibilities of replicating this in Africa. There is no regional growth point in Africa from which such a cascading process can begin. There is no good neighbour who is sufficiently organised, not only to achieve its own modernisation, but then also to organise a dynamic process of cascading of growth to those nearby. One possible exception, of course, might turn out to be South Africa. But unless you can get that growth pole in the South African area, it is difficult to think of this kind of systematic long-term spread effect to neighbouring countries.

There is another point that I would like to flag, which is prompted by the reference in Robert's paper (page 6) to economists' conventional notion of the factors of production as land, labour and capital. One has to think of the factors of production in a new way. In his remarks, Robert referred to Adrian Wood's work on the new basis of comparative advantage. The underlying idea here is that nowadays capital is mobile, and can be attracted in the right conditions. It's not a fixed given which determines comparative advantage. The factors which are relatively fixed are land and skills. This highlights, even more strongly than Robert puts it himself, the role which skill formation needs to play in a process of growth through expanding manufacturing exports. I am far less convinced than Robert is that agricultural exports will play the same role in a growth process, at least the rapid growth process. In the long run they may, but in terms of the sort of growth rates we are looking at in the East Asian case, the dominance of manufacturing exports seems to me to be very strongly indicated.

What else can be said of the ingredients of the so-called "miracle"? I am fascinated by the story of the role of the government and I accept what Robert has said, and what Robert Wade said also, about the precise ways in which the government has intervened. I would stress that it hasn't all been beneficial and that even with the human skills which were available in Korea, the government did encourage the over-extension of certain industries, such as ship building and heavy chemical industries, in the 1970s. That was partly what precipitated the brief crisis for which adjustment was required between 1979/83. The story has not been one of the unqualified success of government intervention. Governments, even the

Korean government, can make mistakes about which the right industries for the country are.

Interestingly, the Korean government is by no means a text book case of good government. It is a highly repressive regime which now appears, from reports of the trials of the Presidents of the country, to be extremely, grossly corrupt. What is interesting about this is that the corruption seems to have been very direct (i.e. give me a large brown envelope) and not a form of corruption which was operated indirectly through wholesale distorting of the economic system. I think it characteristic of a lot of developing countries to construct systems of economic management which are basically there to generate rent. If you have a system which is so blatant that you simply demand payments, you don't necessarily need to go through an indirect route to get the pay-offs to the right people. It may be a blessing in disguise that some Asian authoritarian governments practised direct rather than indirect corruption.

Coming back to the question of what are the factors which give comparative advantage today, I would like also to mention factor number four – something called social capital which is now coming into vogue. I have a feeling that social capital may be a concept which has been overdue for recognition in the vocabulary of economists. Social capital is essentially the social networks of trust, the density and nature of such networks, which lie outside market and government relationships, and which then condition the effectiveness with which both government and market operate. There are few empirical studies of social capital in developing countries. The best we have is of Italy by Robert Putnam, which itself is still controversial. I suggest on the research front that this is a very important area. Social capital is a kind of mediating factor in the nature of society. This is something distinct from human capital formation as such. It is to do with the way in which people interact with one another, whether on a horizontal plane, as it were, across society or whether interactions are channelled in a vertical linkage of patrimonialism or patriarchy. This could be vital in understanding why a given economic strategy works out differently in Asia and in Africa.

Now I think that I have probably used up my time. I have more comments to make but I don't want to trespass too much on your goodwill.

Comment by Dr Sanjaya Lall

Queen Elizabeth House, University of Oxford

Thank you very much. I find myself in a very difficult position. I start by saying that Robert's paper is excellent – it is wide ranging, it is comprehensive, it is practical and it is wise. As with John Toye, I have not much to say on the content of the paper itself. Some of the things I was going to say have already been said by John Toye, so I find myself in a doubly difficult position. So I will talk about two things which might stimulate discussion: (1) what was the East Asian strategy; and (2) what does it mean for non-East Asian countries, in particular Sub-Saharan African countries.

There was no single East Asian model but rather a series of very different models, governments, and political economies addressing very different objectives. Now how do economists deal with this? Economists when they talk about government policies, view the need for intervention as being driven by market failures. Market failure is a very impressive term. Economists immediately think they know what the other person is talking about. Market failures are deviations from a competitive market equilibrium. Non-economists of course, are totally confused by all this, they are very impressed and view what economists are saying as being correct. However, market failure is the wrong word to use. We are really talking about overall government policy which is not simply market failure, but something much broader. So the use of the market failure terminology in describing what the East Asians were doing is really rather confusing. To deal with market failures, there are three major kinds: externalities (when prices don't capture what really is going on), public goods, (something which has no price and therefore the government is forced to provide it), and the regulation of monopoly (enforcing of competitiveness). These are relatively trivial policy issues. The policies which the East Asian countries adopted were not dealing with market failures in this rather static sense. There were elements which all governments were doing, and upsetting the rules of the game in the process, such as providing infrastructure. Yes, these were addressing market failures in the trivial sense. But what they were doing was really quite different. There are five points I wish to make on this.

First, is that each of the four East Asian dragons/tigers, adopted very different strategies which had nothing to do with addressing market failures in the static sense. So we must talk about government strategies to improve markets. They were creating new markets, altering the structures of markets, creating new endowments and institutions within which markets functioned, and they were really changing the whole social structure within which the markets were operating. By no conceivable means can we, as economists, talk about this as a process of correcting market failures.

Let me give you an example: each of these countries started with a simple industry – the most prominent being garments. Garments were the easiest industry to get into – with three months of training, a literate labour force and a few technicians, a country can export garments efficiently in the world market. Once you start doing this, is there a market failure involved? Hong Kong says that the market has determined that we should be in a simple area of labour-intensive products like garments, leave it to the market and there we will stay. A smaller economy, Singapore comes along and says no we do not want to be in garments at all. We see that, ten years down the road, garments are going to be uncompetitive. It is a very easy industry to get into and therefore we should aim for something much more complex. Let us go for capital-intensive industries like petro-chemicals, ship repairs, etc. Ten years later, they say even this is not enough, let us go for high-technology electronics. There is no market failure involved. It is a question of strategy. Take Korea, which started with garments, and said we do not want to be in garments at all, we prefer to be in heavy industry. But unlike Singapore, which depended on multinationals, we want to build up our own technology base. So, from garments they go into textiles, from textiles, they go into textile machinery, and from textile machinery they go into machinery making and electronics in general. We do not want to depend on multinationals, therefore, we have to create very large firms. We have to create a domestic technology base, we have to do research and development, etc. They were not addressing market failures. The same markets existed. They all started the same way. Addressing different objectives – they were changing the whole structure within which the economy operated. So that is the first point – we are talking about industrial strategy and not market failures.

Secondly, the most important point, is that each country had a very different strategy, as I indicated. Hong Kong had a strategy of "laissez-faire"; it started with unique initial conditions, took off, did very well for a while industrially and then started declining. Hong Kong is presently undergoing the most massive de-industrialisation of any of the tigers. Initially, the other economies' industries remain at 30-40 per cent of GNP and continue to grow 7-10 per cent per annum. Hong Kong's industry is growing at only 1 or 2 per cent. Manufactured exports are declining in real terms by 10 per cent per annum. In contrast, Singapore, a much smaller economy with much higher wages, has not suffered de-industrialisation. Its manufactured exports are growing at double digit figures. Unlike Hong Kong, Singapore adopted free trade, combined with massive interventions to attract foreign investment and to direct them into particular industries. Where foreign investment would not come in, the Government of Singapore created public enterprises to act as a catalyst to foreign investment inflows. Then you have Korea and Taiwan which went much further and limited foreign investment to very high-technology industries, and created other industries with national enterprises. Very different strategies with very different implications – each for very different structures of industries, very different structures of exports and, in the long term, probably very different propensities to continue growing at a high rate. Today, we find Hong Kong declining, Korea and Taiwan maintaining the highest rate of growth and Singapore nearly there.

The third point relates to what the World Bank called functional or market-friendly interventions. The World Bank now admits that there is a role for governments but that they should be non-selective – one should not pick winners. Functional interventions are very important for providing good infrastructure, good macro-economic management, basic skills and so on. They are necessary conditions for growth, but not sufficient. Functional interventions by themselves (like in Hong Kong) are not enough because you get to a certain point beyond which your static comparative advantage runs out – simply creating skills is not enough. One then has to go in for much more selective promotional policy, either within a free market, like Singapore, or much more targeted and interventionist, like Korea or Taiwan.

The fourth lesson from the larger economies, like Korea and Taiwan, is that it becomes very important to build a domestic technology base. Large economies cannot be driven, like Singapore, purely on the basis of foreign investment. They have to start building a domestic technology base which, for a long time, means not innovating on the frontiers of technology. The ability to diversify on the basis of imported technology is a very different proposition to doing R & D. It is to use imported technology effectively – to make VCRs, microwave ovens, colour televisions on the basis of technology innovated elsewhere. Needless to say, to develop a domestic technology base requires considerable government intervention.

I suppose the fifth lesson, which follows from this, is that the NICs were not picking winners but they were creating winners. They were not addressing market failures in which the market has a mass of information which governments find it impossible to process. The neo-classical view that governments can never really be more efficient than markets, simply because there is too much information around, is probably true in a static sense. But when a country changes the parameters within which markets operate, it does not face the same sort of problems. What these countries were doing was guiding the economy into hi-tech, high skill industries (like electronics), and they are doing it in a coherent fashion. They were creating all the conditions which were required for firms to become efficient. So it is not just protecting hi-tech industries. You offer a bit of protection and you offset protection by forcing firms to export. In order for the firms to export efficiently, you create a base of skills – these skills are not generic skills (high school/graduates) – they are very specific, targeted skills in the particular industries that they were setting up. It is a very coherent, integrated strategy of making things happen. Its feasibility is shown by the East Asian experience – whether it is easy or not is very difficult to say. Picking winners is wrong and is very difficult. Creating winners is difficult but it is possible; it is a necessary part of the development strategy. So what does all this mean now for non-East Asian countries, especially Sub-Saharan Africa?

First, of course, past patterns of interventions were wrong. There is no excuse for going back to old-fashioned import substitution with an enormous inward-looking public sector. Countries have to liberalise and they have to globalise. The content of liberalisation and globalisation are not very clear; there are many different ways to approach this argument objectively. To become efficient in world trade, implies growing rapidly with an expanding, efficient manufacturing sector. How do we do this? One set of prescriptions is structural adjustment, a big bang opening of the economy and letting markets do all the work. Based on the theory that markets are ultimately very efficient and governments are basically very inefficient, you open and liberalise and you become an East Asian tiger. Experience does not bear this out in Latin America or Sub-Saharan Africa. It is difficult to talk about Asia because this region was never really liberalised in this fashion. The Asian pattern of liberalisation has always been a much more controlled pattern, with a very large role for governments.

I was looking at the case of Ghana which has the longest history of structural adjustment in Sub-Saharan Africa (about 8-12 years, depending when you date structural adjustment). It has the longest history of consistent structural adjustment in Africa, they have devalued, privatised, opened up foreign trade and they have done everything by the book. What has been the result? An initial burst of economic growth of 10-12 per cent, while excess capacity was being used up, and imports were coming in to feed existing capacity. Once competing imports start to be liberalised and excess capacities are used up, the rate of growth goes down to 5 per cent. For the past five years, they have been growing at 1 to 2 per cent. In per capita terms, there was a decline in manufacturing growth. Is there a surge in manufacturing exports? Resources released from inefficient activities automatically seeking out efficient activities, going into labour-intensive products, as one would expect? No. The textiles garment industry and the footwear industry were devastated. In fact, every industry in which Ghana should be following Hong Kong is declining. The few manufactured exports which are growing are resource based. These have always existed, and show very little sign of dynamism. Total manufactured exports from Ghana two years ago were less than $15 million, it is not doing a tiger. Why? Because the government opened up very quickly without preparing industry to compete overseas. Even in a simple labour-intensive industry (like textiles and garments), a lot of work is needed before you become a Hong Kong. Hong Kong had very unique circumstances before it took off, even with labour-intensive industry. What happens is that big bang liberalisation realises comparative advantage, but it realises static comparative advantage. It does not redo the process of dynamic growth. And the process of dynamic growth requires functional interventions, building skills and so on, but it requires so much more. It requires economising on scarce resources – marshalling the skills , technology and management in order to go into a few activities which have a chance of making it in the world market.

The lesson that one draws from this is that liberalisation is necessary but in the process of liberalisation one has to be selective. It is not a sudden opening up to market forces, because market forces are very cruel; they can destroy a lot of industry which basically is viable. In addition, the realisation of comparative advantage is very static and there are cases in Latin America where, over a long term, comparative advantage had developed much more slowly than East Asia. The story of East Asia is that governments compressed and made dynamic the process much faster than market forces would.

The third lesson is that you must liberalise more gradually. But just slowing down the process of liberalisation alone is not going to help anyone. Simply protecting inefficient industries for another 10 or 15 years is a total waste of natural resources. Liberalisation has to be geared to and integrated with the programme of building supply-side capabilities – building skills, technology, institutions and whatever firms need in order to become efficient in whatever industry they happen to be in or the next stage of industrialisation. In short, there needs to be a coherent strategy. Markets themselves will not produce the strategy. One is talking about competitiveness but not competitiveness strategy in the way Michael Porter goes around advocating to developing countries. Large numbers of companies, like the Monitor Groups, are selling competitiveness packages to different developing countries. Lots of business school jargon but not much economic content in it because they do not have the economic analysis behind it. Where do markets function, where do they not function, what is the role for government in creating strategy? I think it is a very important area of work for research on what develops competitiveness in the context of liberalisation and globalisation.

The fourth point, the most important aspect of adjustment, often neglected, is the building of government capacity. Industrial capacity will not come unless there is the capacity to design and administer the right kinds of policies. Building government capacity is partly the structural adjustment prescription of downsizing government and firing inefficient bureaucrats, but this is the negative side. The positive side is that you have to develop government capacity in terms of the information available in order to devise effective policy. What did the East Asian actually do, how did they support their industries, how did Taiwan with its nearly one million small to medium enterprises manage to get them into export markets at the frontiers of technology and keep them there? What kind of support was needed? Do we understand this? We know that Taiwan, for instance, had the world's most effective system of supporting small to medium enterprises. A lot of institutions provided capital, technology, training, skills, but we do not know the details. I think there is an enormous amount of work in terms of research to understand what they did. It is an enormous amount of work on the part of governments to understand what other governments did – information and, of course, building skills, building the capabilities, insulating them from political influence, we all know, but I think the basis of adjustment must be to build up government capabilities.

The final point is how much scope is there left for replicating the East Asian diverse strategy? I think Robert's paper touched on this but didn't really discuss it. The new emerging rules of the game – the World Trade Organisation, Structural Adjustment, pressures from donors and so on – are really narrowing very much the scope for industrial interventions as they were practised 20 years ago, and much of it is very healthy. Of course, a lot of interventions were disastrous. But it is narrowing the scope compared with what Korea, Japan and Taiwan did and, to some extent, that is very undesirable. How much scope is there left? We are faced with this juggernaut of liberalisation rolling along and it is very difficult to turn it back. I think on the whole, the effects of liberalisation are more positive than negative. But we have to retain some scope for interventions in trade, which is most hit by the rules of the game. There is also lots of scope for domestic policy interventions. This is, again, an important subject but I don't know enough about it and I think a lot of work needs to be done.

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