THE CHANGING ROLE OF GOVERNMENTS IN ATTACKING POVERTY

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Rethinking the role of state in our changing world has led to a movement of ideas about determining the contribution of state in a growing economy. We have moved from no-intervention free market to a market-friendly approach to development and from a market-friendly approach to "effective government" approach. The state has played a very important role in "miracle" NIC's growth. Various reports show that the "effective government" was behind all these miracle growth. As the world Development Report 1997 states "the state is central to economic and social development, not as a direct provider of growth but as a partner, catalyst and facilitator". The question here is that, with the newly defined role of government, can the Third World nations develop in this new millennium? Economists have differing views. The last 50 years of economic activity has witnessed emergence of Asian Tigers within the third world nations. A perfect example is the Republic of South Korea. This third world nation raised its per capita income from under $500 US to $13,500 US in 1999. This sharp increase in such a short time raises two questions. Firstly; how was this increase in per capita income achieved and secondly; who were the beneficiaries of this growth?

Earlier theories of economic development, in the Third World, focused on the structural transformation and large investments in physical capital. After about five decades the transfer of surplus human capital (from traditional sector into the modern sector) and large investments in physical capital (enlargement and enrichment of modern sector) is still continuing in most of the developing countries. In recent years governments of the third world nations have shifted their focus to market-based development strategies and moved away from planning model. This is a significant shift in ideas. A "market-friendly" approach to development is widely accepted as the basis for economic growth and technological progress. The private sector can help to make economies quick and responsive enough to compete in today's fast growing and moving international markets. The private sector can play a complementary role in reducing poverty and securing sustainable growth by relieving governments of excessive responsibilities and financial burdens. This means that the government and the private sector must move together.

The government must be an "Effective State". According to the World Bank (World Development Report) an effective state is one, which "harnesses the energy of private business and individuals, and acts as their partner and catalyst, instead of restricting their partnership."

In the World Development Report, 1997, the World Bank came out against a minimal government presence and its role in the economy. According to the World Bank development --- economic, social, and sustainable - without an effective State is impossible. For example, the government of Korea had more control over an upcoming enterprise than even in the Soviet Union although Korea was a free market economy.

Most of the East Asian countries such as South Korea and Malaysia have proven that market-based strategies and policies are effective and bring sustainable growth. Market-based development strategies result is faster growth as compared to the planning model strategies. Countries that are staying with planning model strategies, in most cases, exhibited negligible or negative growth. Some nations had experienced stagnation or even collapsed. The examples of many socialist economies can be given in this regard. Pakistan could manage to raise its per capita income to slightly over $400 US in 1999. Since the early 80's the country has focused on privatization of the State owned enterprises indicating the need for speeding up of the growth rate. The basic ingredient in this growth appears to be the Governments' help and guidance in the creation of domestic and foreign markets.

The emphasis in the government's help and guidance is placed on a balance between total control of the economy and complete *laissez-faire*. At different stages of development and in different situations countries will and should choose different pointers. In order to achieve such a balance governments must understand the developments that have taken place in the economic theory. They must also understand the causes and consequences of the emergence and disintegration of Asian Tiger economies. The Government of South Korea helped and guided in creating markets rather than completely supplanting or surrendering.

The dramatic failure of the grand socialist experiment had an unanticipated consequence: it lent support to extremists of the opposite ideological group, according to whom government should play almost no economic role. But the rejection of one extreme is not the affirmation of the other. The real issue that both the success of East Asia and the failure of the socialist experiment raise is, what is the appropriate role of government in market-based economic activity? To be sure, economists have long recognized the need for selective interventions in the marketplace to remedy well-identified problems such as externalities. But developments over the past thirty years have shown that well-designed government actions can improve living standards whenever there are imperfections of information or competition or incomplete markets-problems that arise in all economies, especially in developing countries. The use of the word "can" here is crucial. Not every market "problem" calls for government action. In order to raise living standards, government actions must meet two criteria: they must address some serious imperfection in the marketplace, and they must be designed efficiently enough that their benefits outweigh their costs.

It has been argued by some economists that government is unnecessary, ineffective, and counterproductive. They list three basic flaws in the role of the government. First of all they believe that anything government can do, the private sector can do better. Secondly anything the government does, will be offset by actions of the private sector, and thirdly rather than improving resource allocations, government interventions actually make matters worse, especially because of rent seeking. Historically, East Asian countries have proven that government's market-based economic strategies have produced high rate sustainable growth. The second assumption is true only under highly restrictive conditions. As for the third, the historical evidence shows that government actions can make a difference for the better. However, both theory and evidence show that concerns about rent seeking, while real, are typically exaggerated. For rent seeking to completely dissipate the profits generated assumes perfect competition in rent seeking. The fact remains that any arbitrary intervention will necessarily improve matters. However, the full impact and consequences of proposed action must be carefully assessed.

History, more than theory, can provide guidance on choosing the appropriate role of government and its magnitude and intensity. Even the developed nations where economies are primarily market-based, governments have played highly significant role for monitoring economic growth. In the United States for instance, growth is attributed to selective government actions. However, there is the ever-present problem of the counterfactual. Would these economies have grown even more quickly if government had not taken the actions it did? In the United States and the East Asian countries government played six important roles that have spurred development.

RULES OF THE GOVERNMENT ROLE

Markets perform their central role of increasing wealth and living standards in the societies. In order to perform this function, markets require the infrastructure namely education, technology, financial, physical, environmental, and social infrastructure. The primary role of government is viewed as establishing this infrastructure in its broadest sense. Because constructing the broad infrastructure is beyond the capacity or interest of any single firm, it must primarily be the responsibility of the government.

EDUCATION

The New Growth Theory emerging in the economic literature since 1990's suggests that the miracle growth of the NIC's is mainly due to human capital formation. One of the important elements of human capital formation is the provision of education. Promoting education is the first role economies of the developed nations such as the United

States and the developing nations like that of East Asia, have in common. Even before the adoption of the U.S Constitution the federal government of the United States, in the Northwest Ordinances of 1785 and 1787, recognized its responsibility for promoting public education. It set aside land in the newly formed states for this purpose. Later, in 1863, the federal government helped establish the public university system. The East Asian economies also emphasized the role of government in providing universal education, which is a necessary part of their transformation from agrarian to rapidly industrializing economies. Universal education also created a more egalitarian society in East Asia, facilitating the political stability that is a precondition for successful long-term economic development. In pursuing such egalitarian policies, the economies of East Asia, led to rest the trickle-down theories of development.

According to World Development Report 1997, "increasing the average amount of education by one year raises GDP by 9%. This holds for the first three years of education i.e. three years of education compared to none raises GDP by 27%".

Simon Kuznets had argued that economic growth was associated with an increase in inequality; Arthur Lewis had suggested that such inequality would increase savings and hence growth. The East Asian economies showed that high levels of saving could be attained in an egalitarian setting and that human capital accumulation was every bit as important as - if not more important than—increase in physical capital.

TECHNOLOGY

Promotion of technology is the second role a government plays. As recently as 2001, India banned emigration of human capital related with computer technology. Developing countries, such as Pakistan, have embarked on intensive plans for developing software. Earlier in 1978 the U.S Constitution recognized the importance of science and technology by giving Congress the right to grant patent rights to protect and promote the progress of science. Even in the early part of the nineteenth century support for research went well beyond the establishment of a system of intellectual property. In 1942, for example, the U.S federal government financed the world's first telegraph line, between Baltimore and Washington. In the nineteenth century agriculture was the main stay of economy, accounting for more then 35 percent GDP in the 1870s. The remarkable productivity growth in the agriculture sector is largely attributable to the federal government's support for research and dissemination of its result. The governments in East Asia have also played a central role in the promotion and transfer of technology.

FINANCIAL SECTOR

The third role of government is in supporting the financial sector. In developing countries the financial resources are scarce and at times governments are depicted as the brain of the economy deploying these scarce capital resources in the most efficient way. It is concerned with gathering, processing, and disseminating information-precisely in the areas in which market failures are often most marked. In 1863, the United States recognized the need to create national financial stability; this legislation did much to reduce the financial instability that had characterized the economy up to that time. In later years the government created the Federal Reserve System as well as a series of financial intermediates to spur markets that had been thin or nonexistent. Similarly, East Asian government took an active role in ensuring the safety and soundness of financial instructions and in creating new institutions and markets to fill gaps in the private sector.

INFRASTRUCTURE

The fourth role of the government is developing and investing in the infrastructure, including institutions as well as roads and communication systems. In both the United States and the successful East Asian economies, government created institutional infrastructures within which competitive markets could thrive. Only recently, as the formerly socialist economies have struggled to establish market economies, have we become fully aware of the importance of this institutional infrastructure, which includes property rights, contract and bankruptcy laws, and policies to promote competition where it is viable and to regulate markets where it is not.

ENVIRONMENTAL PROTECTION

The fifth role of government is in preventing environmental deterioration. Although economists have discussed the need for government action to correct market failures, the concept of environmental protection has become widely accepted during the past three decades. Good environmental policies should not confuse increase in GDP with increase in standard of living, or increase in measured GDP today with increase in long-term wealth. Recent attempts at building "green" GDP recognize these points. They highlight the enormous challenges faced by countries that have not prevented environmental deterioration. It will take generations to undo the environmental damage that has been brought in many developing and transition economies.

SECURITY AND SOCIAL SAFETY NET

To grow at faster and sustainable rates it is necessary to avoid violent social dislocations. An "effective government" can only do this by the following measures

1. Equality before law without which development is not possible
2. Minority rights
3. Public education
4. Anti-discriminatory policies
5. Good governance i.e. bringing the government closer to people

Can all the above be provided by the private sector alone without an effective government role?

For development, economic security, personal and community security and political security are essentially required. All these type of securities have been provided in the developed world in the last few decades. We must remember that the security element that was never and will never be the duty of the "market" has been included as an essential part of various human development indexes.

This role of government in creating and maintaining a social safety net includes access to basic health services. In some cases these activities can be justified in utilitarian terms. They increase the productivity of the labor force and foster political stability by reducing opposition to change. They may also be justified in terms of basic values. Standards of living embrace more than the variables captured in GDP statistics. There is a fundamental need to recognize the fact that protection and improvement of the environments, for instance improved health conditions, represent an improvement in living standards even if such an improvement is not reflected in GDP. Virtually all societies have provided social safety nets, albeit not always through the government. For at least two reasons government today may have to assume a larger role in providing safety nets than either the U.S. or East Asian government did at comparable stages in their countries' development. First, the pressure of urbanization calls for a stronger government role. In 1975 just over one third of the world's total population lived in the cities. Second, in the transition economies large firms traditionally provided much of the social safety net (such as pensions and health care). The transformation of these economies is being accompanied by the shedding of these social responsibilities by corporations facing new competitive pressures. The government is the only backstop.

To support our ideas we can look into the fact that the governments that have been thought to advocate a "minimalist" role of government have turned to market friendly development strategies and now to effective government strategy. It is strange that these countries have always been spending a greater amount on social security and welfare as compared to centrally controlled economies.

The figures in the following table clearly show that countries like USA, UK and Australia have been spending more than one forth of total expenditures on social security. On the other hand, it seems that the countries advocating a full role for the government to play have given less priority to social security and welfare and spend more on just "governing" and "controlling".

EXPENDITURES ON SOCIAL SECURITY & WELFARE IN US $ AS PERCENTAGE OF TOTAL EXPENDITURE

COUNTRY	*1981-90*	*1991-95*
EGYPT	11.9	10.4
SYRIA	4.2	2.0
COLOMBIA	16.7	8.3
UK	30.0	30.5
USA	29.9	28.5
AUSTRALIA	27.7	32.5

SOURCE: WDR-1997

In all types of economies government must play the six roles outlined in the earlier paragraphs. However, it must be noted that there are special problems facing developing and transition economies, in which markets are lacking, markets that do exist may function less effectively, and information problems are more severe than in industrial countries simply because of the rapid change in the economic environment. While market failure loom larger in developing and transition economies, the capacity of the government to correct this market failure is often weaker. Successful government has helped create markets (such as bond and stock markets and long-term credit institutions). They have established and enforced laws and regulations that have made financial markets more stable and increased competition in all sectors. In many cases government have acted as surrogate entrepreneurs, encouraging the establishment of firms to enter certain markets. Especially in export markets, government has provided firms with strong incentives. (Some econometric evidence suggests that many of these interventions were quite effective. For example an analysis of the mild financial restraint evidenced in most East Asian economies suggests that it did lead to more rapid economic growth.)

Most economists today accept the proposition that markets alone may not succeed in ensuring economic efficiency and may fail to protect some segments of the society from abject poverty. While most economists also agree that such shortcomings might provide a rationale for government action in principle, some argue that government interventions all too often have been counterproductive in practice. The question is, can responsible governments put in place policies that raise living standards? Experiences of East Asia and the United States reflect a resounding yes. Some critics of the role of government argue for a different perspective on the East Asian experience. They contend that all – or almost all of the growth of the East Asian economies can be accounted for by the factor accumulation. Thus, they argue, that there is no miracle but simply the inexorable working out of standard fundamentals. Increased inputs lead to increased outputs. 'Total factor productivity growth has been negligible.

Studies reporting these results have raised several technical problems. For example does anyone who studied wage setting in South Korea really believe that wages are set in a competitive process, so that the real wage equals the marginal product of labor, as most of the studies assume? Even if we take low total factor productivity growth findings at the face value, these studies do not really address the question of whether government policies made any difference. They neither ask nor answer questions such as these:

Why were savings rates in East Asia so high? Elsewhere comparable savings rate had been attained only under the compulsion of strong government force, as in the communist countries. Although econometric studies suggest that East Asia's saving rates may be partly explained by traditional economic factors, government actions also played a constructive role.

Why were the East Asia economies able to invest efficiently at such a rapid pace? Other countries (the former Soviet Union is the classic example) have invested heavily but ended up with high incremental capital-output ratios rather than rapid growth. Government efforts to create effective financial institutions combined with the practice of providing funds to firms that proved their mettle in the competitive export markets surely contributed to the efficiency with which East Asia's capital was allocated.

How were the East Asia economies able to reduce the technological gap between themselves and the most economically advanced countries so quickly? The East Asian economies demonstrated an enormous capacity to absorb both capital and technology. Government played a major role in investing in human capital, allowing foreign investment (with some exceptions), and creating an economic atmosphere conductive to foreign investment.

How did the East Asian economies ensure that the benefits of rapid growth were shared broadly across the population? As already noted, the increases in inequality that earlier experiences had suggested inevitably accompany development simply did not occur in East Asia. To the contrary, there are reasons to believe that greater egalitarianism- a result of deliberate government policies - actually contributed to the remarkable growth in these economies.

The question raised at the beginning may let the reader think that may be, by a drastic change in the governments role, development is a must. But this is not necessarily the case.

The governments traditionally had two choices. One, the import substitution policy, which has historically proven to be a failure and second, the outward looking development strategy, a big success story as proven by the growth of NIC's. But can other countries follow the example now? The answer may be a NO! Why? Because the situation is entirely different as compared to the 1960's (The starting period for the emerging tigers) e.g.

1. The real prices of primary commodities have declined significantly and having low price elasticity, we cannot generate the exceptionally large export revenues now as the NIC's did.

2. During the 1960's Europe and USA, the 'main purchasing power holders' were passing through the second stage of demographic transition i.e. an above 2% population growth. So the demand for LDC's products was increasing at that time. But now the population growth rate in the main buyers of LDC's products is almost at replacement level.

3. The incomes of DC's are not growing at good rate as compared to the period when the NIC's grew very fast.

4. More competition, more quality consciousness and development of cheap synthetic substitutes of different primary level products has made a 'big push' very difficult.

5. Globalization has and will further increase the Multinational Corporation's grip on the world markets so 'new tigers' may not emerge.

CONCLUSION

It is a fact that the global world of today is experiencing changes that are extraordinary in nature. Societies must accept these changes as they happen and where they happen. Societies accepting such changes will do better than those societies who do not accept such changes and that will be reflected in the levels of living of these societies. The earlier development experience by the now developed nations lacked the benefit of the insight that is now available to the now developing countries.

Some of the constants in development and theory are putting competitive markets at the center of an economy, with governments acting to assist, use, and supplement those markets, providing public investment in education and technology, and constructing appropriate institutional infrastructures, including those that support dynamic and competitive telecommunications and financial sectors. Government must perform better and provide basic safety net and protect the environment. Leadership can help articulate visions of these roles. It is, however, the desire of the people, whom government is supposed to serve, that will determine both the scope of government and its ability to be a positive and creative force. But, the most important thing is to be careful while applying different historically proven models because we must consider the difference in the conditions and circumstances that time has created.

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