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*Published in:*  
The Broker

[Link to publication](#)

*Citation for published version (APA):*

Pouw, N. R. M. (2011). When growth is empty: towards an inclusive economics. *The Broker*, 25, 4-8.

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Towards an inclusive economics

# When growth is empty

The pursuit of endless growth and the ensuing global financial crisis have eroded public trust in economic policy. As a result, an increasing number of economists are advocating a more inclusive global economy.

The recent financial crisis has exposed the weaknesses of the market-driven approach to social and economic policy. Not surprisingly, the failure of the liberalized, efficiency-driven system has policy makers around the world looking for new ways of organizing their social economies. Economists from different schools of thought have been calling for the global economic system to be revised for decades, but often in isolation from one another. The financial crisis seems to have united economists, however, in an effort to promote a more inclusive global economy.

The financial crisis has also convinced many economists to go back to the drawing board. Orthodox economists from the neoclassical school, whose ideas rest on the assumption that there is perfect market equilibrium, fear that the strength of the discipline will be put at risk. But many others, including leading economists such as Amartya Sen, Joseph Stiglitz, Dani Rodrik, Jeffrey Sachs and Paul Krugman, argue that ethics and morality, and culture and context, need to be reintroduced into economics.

## New way of thinking

Paul Krugman, 2008 Nobel laureate in economics, gave his *New York Times* article from 2 September 2009 the heading ‘How Did Economists Get It So Wrong?’ He argued that economists had failed to predict the global economic crisis because they were ‘mistaking beauty for truth’ in their mathematical models. The economics profession had been blind to ‘the very possibility of catastrophic failures in a market economy’.

This critique stands out as one coming from the heart of the discipline itself. It follows a longer series of self-reflections in works by development economists, such as Stiglitz’s 2002 book *Globalization and Its Discontents*, and

## summary

- The global financial crisis has exposed the weaknesses of the liberalized economic system and resulted in calls for a more inclusive global economy.
- Leading economists, such as Amartya Sen, are stressing the need for ethics and morality, and culture and context, to be reintroduced into economics.
- Human well-being, therefore, should be the central goal of economic performance and social progress, and not material welfare.
- Any new measure of economic performance needs to also assess the value of social provisioning – goods produced by unpaid economic activities, such as household and community production, and unpaid goods and services.

Rodrik’s 2004 book *Rethinking Growth Policies in the Developing World*. They warned against the pitfalls of economic development ‘blueprints’.

Sen, ethical guide for many development economists, has urged for the re-evaluation of the ethics of economics and a revision of its underlying concepts from a more inclusive perspective, most recently in *The Idea of Justice*, published in 2009. Likewise, US economist Sachs stresses in his 2010 article ‘Rethinking Macroeconomics’, published in issue 18 of *The Broker*, ‘that future prosperity will require basic reforms in global macroeconomic governance [and] new ways of thinking’.

These calls for a more inclusive economics and a rethinking of the field’s underlying concepts also found voice in a landmark report, *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, published in 2008 by the Commission on Growth and Development.

The report states that ‘growth strategies cannot succeed without a commitment to equality of opportunity, giving everyone a fair chance to enjoy the fruits of growth’. Inclusive growth should be achieved through policies that stimulate productivity in combination with new employment opportunities. Persistent inequalities, argues Ravi Kanbur, one of the contributors to the report, should be addressed

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Alamy / Justin Kase

from the outset as they tend to undermine the sustainability of economic growth. But it is difficult to pinpoint the market-based economic model's sore spot because social relations are not reflected in economic models. By the same token, economic analysis does not factor in exclusionary practices.

Attempts to re-think economic policy making were also made in the 2009 report by the Stiglitz Commission. The report went a step further than the CGD report by proposing a more encompassing welfare concept and suggesting that economic accounting frameworks be reconsidered. The Stiglitz Commission's report re-ignited the debate on the limits of growth and the related measures of economic performance among economists in the worlds of academia and policy making.

It is highly unlikely, however, that a new measure will be enough to steer economists away from the perpetual growth mantra. Economists need to urgently scrutinize the field's underlying concepts and lay the foundations for a more inclusive economics framework.

### **The perils of growth**

The standard neoliberal recipe of stable capital markets, privatization and liberalization, combined since the 1990s with donor-led national poverty reduction programmes, has yielded precious little. But progress has been made in some former low-income countries. The growing middle classes of

India and China attest to a rise in average per capita income and improved food security. This progress appears to be mainly the result of economic policies that have little to do with the Washington Consensus.

Indeed, governments in countries such as India and China have chosen to pursue their own development strategies. Targeted, government-controlled reform policies – including high savings and government investments, together with foreign direct investment – have fuelled growth in concentrated areas in these countries. Average incomes have also grown in these countries, thanks to more recent policies that stimulate migration and remittances, social spending, industrial relocation to poorer areas and investment in agricultural production.

Some regions in China and India have benefited more than others, however, with far-reaching consequences for those that have ended up with the short end of the stick. The latter have suffered irreversible losses of livelihood and natural resources. There has been massive displacement of minority groups searching for income opportunities. Social services in cities, unable to keep pace with the rate of urbanization, are inadequate. This is widening the inequality gap.

High growth figures in countries such as China and India generally downplay inequality and environmental damage as inevitable by-products of economic success. Increased productivity and employment opportunities do increase welfare on the whole, but they alone do not have the power



to reduce inequality or ensure environmental sustainability. Growth, of any kind, frees sorely needed money for investment. What to invest in, remains subject to the will of those in power.

### **Building blocks of inclusive economics**

Those who advocate inclusive economics do so on the basis of the realization that two key changes have taken place in economies worldwide. This is the conclusion of the Stiglitz Commission's 2009 report, *The Measurement of Economic Performance and Social Progress Revisited*.

Firstly, the authors take into account the changing structure of national economies worldwide. New sectors are emerging, such as highly specialized private medical and financial services. And old sectors, such as manufacturing, are either disappearing or are being relocated. The relationship between paid and unpaid economic activities, and between the formal and informal economy, is changing.

New national accounting tools are needed to capture the estimated values of scarce resources for which there is no market or market price, such as household goods and services. For example, the output of education and medical services, provided by the government, has always been badly measured. Likewise, the economic value of non-market goods and services is difficult to measure in monetary terms. The United Nations Statistics Division is seeking ways to integrate values of household production and the informal economy into systems of national accounting.

Secondly, the authors recognize the changing social values assigned to economic performance and our legacy to future generations. Social justice, democracy in a broad sense, environmental sustainability and real opportunities for the poor are gradually becoming central issues in the global public media. The Stiglitz Commission's report is only one example of the call for a more pragmatic, reality-based approach to economics and an increased focus on the ethics of growth.

### **We are all agents of well-being**

A more inclusive perspective in economics has to ensure that people are part of the equation again, in the tradition of Hungarian political economist Karl Polanyi and social economists such as Mark Granovetter and Richard Swedberg. It must recognize that, ultimately, people's decisions steer the 'invisible hand' balancing the economy. Indeed, real people, with different interests and operating at different levels of power, make economic decisions about the consumption, production *and* distribution of scarce resources, and they, in turn, are affected by decisions made by others.

This 'double movement' in economics deserves more attention. The phrase was coined by Polanyi in his seminal work *The Great Transformation*, published in 1944. It originally referred to the rising market society and government response to this in the form of social protection. The concept has renewed significance in light of today's global economies because though free competition in the

global market may stimulate growth, some people are undesirably affected by economic growth and need protection.

In economics people are ascribed *agency*, the capability to solve economic problems. Individual characteristics, social identity, power relations and institutional contexts influence people's capabilities, and thus their agency. Moreover, economic agents perform multiple roles. They can be producers, consumers, distributors or recipients in the market and public domain. A broader definition of the economy would capture the economic realities of people on the ground. It would also shed more light on the socially and politically determined roles of economic agents.

In the most common definition of the economy the market allocates scarce resources. Polanyi's definition, however, can be described as a process in which economic agents allocate these resources to other economic agents. This broader definition includes factors beyond the market, such as the state and individuals. It also sheds light on the state's role in redistributing public goods and services, as well as exchanges in kind by households, communities and other groups of people. The fact that market exchange is not the only determinant of well-being is one of the things that characterizes inclusive economics.

### **Well-being, not welfare**

Human well-being should be the central goal of economic performance and social progress, and not welfare, which comes down to how someone is faring economically. This premise builds on the broader definitions of poverty, which have been debated ever since Peter Townsend developed his 'basic needs' approach in the late 1970s.

The 'basic needs' concept, in turn, inspired the human development index in the late 1980s. Most economists in favour of inclusive economics also argue for an even more comprehensive measure of well-being than this index, as promoted by the United Nations and Sen. More recently, Allister McGregor, professor at the Institute for Development Studies in the United Kingdom, has promoted an approach to development centred on well-being.

Well-being consists of material wealth, social relationships (including environmental) and psychological security. Well-being, and how it is perceived, is rooted in culture. Together, these three dimensions determine a person's value system and economic choices.

Well-being also has a distinct social dimension. Social well-being emerges out of a negotiation process in which people give up part of their individual well-being for the greater social good. Economic policies promoting equality and sustainability should therefore not focus only on increasing the average level of welfare. They should also focus on the marginalized and give them a voice in this negotiation process.

In neoclassical economics, social welfare is a sum total of individual welfare augmented by individual consumption. In other words, when individuals receive higher incomes and increase their consumption, average welfare increases. The



Reuters / Stephen Hird

means for achieving higher income and growth easily become an end in themselves when other dimensions of well-being are discarded.

The recent crisis, however, has shown that when growth reaches a certain point, it can become ‘empty’ growth. Empty growth no longer represents an increase in real value, as subprime mortgages in the United States have illustrated. Indeed, it undermines the stability of real growth and burdens people with (more) risk and uncertainty. Structural inequities in the social, political or economic system mean that some feel this burden more than others.

The recent crisis has also eroded public trust in financial markets. The pursuit of endless growth has created risk, uncertainty and a lack of trust. So more growth needs to be complemented by something else – by technological improvements to increase real value, for example. This implies the need for social investment (in education and human capabilities, for example, since knowledge fuels technological change).

Governments must therefore encourage public debate and include the excluded. The excluded deserve the opportunity to defend their well-being and demand investments in their capabilities so they can address priorities in their lives. This is a point repeatedly made by leading economists, such as Sen in *The Idea of Justice* and the Stiglitz Commission in its 2009 report. However, a broader welfare concept in itself will not shed light on the *origins* of social inclusion and exclusion. We need to look beyond the market and the state to understand how social relations shape economic decisions.

**Social provisioning**

It is not only the market or the state that generates human well-being. Social provisioning – a term often used to

distinguish between goods generated by unpaid economic activities and goods provided by the market or state – also contributes to human well-being. Think, for example, of household and community production, and the distribution of unpaid goods and services. These activities fall outside the scope of standard neoclassical economics because households and communities are primarily seen as ‘consumers’.

Examples are cooking a meal, taking care of the sick and elderly, cooperating to work on each other’s land, voluntary community work to maintain green areas or roads, and support arrangements. The social ties between people provide an organized social setting in which people cooperate, provide care and organize support to generate individual and social well-being.

Informal arrangements in these social settings determine who has access to and control over scarce resources and capital input. These resources are often shared. A fishing community along the southern coast of India may share the same fishing grounds. Its people’s social identity determines access and ownership of these fishing grounds in the absence of formal market and government regulations. Individual families may even choose to go temporarily poor during the lean season by diminishing their daily fish catch to sustain fish stocks, and their way of living.

Self-fulfilment and reciprocity lead people to engage in social provisioning – not only individual gain. Community membership, as the fishing example illustrates, is regarded as the most important asset. These kinds of economic decisions can only be understood if economic value is interpreted from a broader perspective of well-being.

Social provisioning can strengthen social cohesion and psychological well-being. Many participatory poverty studies see the lack of cooperation between members of rural





communities as a sign of ‘poverty’, when poverty is defined according to the perspective of local people themselves.

A more inclusive economics needs to do the following:

- Make social provisioning visible in the economic system, alongside state and market provisioning
- Regard contributions to well-being in its multiple dimensions
- Look into interrelationships and trade-offs between the market and non-market domains

The economic value of socially and state provided goods and services is hard to measure. There is no ready market price for these inputs and outputs. Other measures need to be designed to assess their value so they can be included in economic analyses. Monetary and non-monetary measures should be used to estimate these interrelationships, and the cultural values of non-market activities need to be explored in more detail.

### **Economic performance**

The above notions of well-being and social provisioning automatically alter the way we think about economic performance. Economic performance entails more than just the rate of economic growth. It is rooted in the combined set-up of state, market and social provisioning activities. The performance of any economy should also be thought of in terms of its ability to enhance social equity and the sustainable use of its resources.

How scarce resources are used is no longer just about efficiency. It is also a question of social equity and environmental sustainability. In other words, ‘efficiency’ is itself subjective. Take, for example, people’s notions of how much time or space is needed to live well, or new indicators, such as ‘the quality of life indicator’. Economic analyses should use these factors as well, and not only money indicators.

Deepa Narayan, project leader of *Moving out of Poverty*, a 15-country World Bank study, reports that in India the role of local governance is vital in enabling people to climb up the ‘ladder of life’. She has constructed a ‘mobility of the poor’ index based on a large database of life histories. These histories tell the stories of people who have either climbed

out of poverty, fallen into poverty or whose situation has remained stagnant over a 10-year period. She then asked them which factors helped them to move out of poverty. Local democracy and family support were cited as the most valuable factors to make lasting progress in life.

Another example using non-monetary indicators in economic analyses is that of economists joining forces with ecologists. The Swedish ecologist Johan Rockström and his multidisciplinary team of researchers have identified nine planetary boundaries in ecological systems. If human activity goes beyond any of these boundaries, it will cause irreversible loss to these systems.

For example, in order to sustain global freshwater resources for future human well-being, countries would have to choose an economic growth path that keeps us within the proposed planetary boundary of 4,000 km<sup>3</sup> usage of water per year. Given the current rate of 2,600 km<sup>3</sup> under present economic activity, this is still within the safety zone. However, the United Nation’s world population growth estimates anticipate a rise from 6.9 billion people in 2010 to 9.1 billion in 2050.

Needless to say, this will put more pressure on freshwater resources. Economic growth and its related human activities is one of the key variables impacting climate change and water use. So it stands to reason that we will run out of fresh water at some point if countries continue to grow economically at the current pace. It is the poor and marginalized in particular that are currently deprived of access to safe drinking water.

From a well-being perspective, investments in individual capabilities as well as physical and social infrastructure could mitigate such risks. Likewise, this perspective sees investments in environmental sustainability as an investment in future well-being, unlike the neoclassical growth theory, which views them as an expense.

Sen argued already in 2000 that economic growth should become instrumental to achieve human well-being, rather than an end in itself. The expansion of people’s freedom to choose is a virtue in its own right. However, the real choices that people have are undermined by more powerful economic agents, which control social, political and economic institutions.

Sen therefore recently broadened the discussion on economic growth to include social justice concerns in *The Idea of Justice*. The question economists should now ask is whether a society wants growth *at all costs*? One answer is to develop a more inclusive economics framework, and not only new proposals for generating growth, new employment policies and new ways of measuring performance. It is not enough for economists should to simply build better models. They need to collaborate with historians, geographers, philosophers and others to better explain economic realities. ■

*The author would like to thank Allister McGregor, Esther-Mirjam Sent and Robert Went for their helpful comments on an earlier draft of this article.*