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The Idea of Inclusive Growth and Development Policy¹

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I. INTRODUCTION

The evolution of development policy over time can be characterized as a faltering pursuit of inclusive growth: namely, an integrated program of achieving highest possible rate of growth of the real GDP that doubles per capita income within a short period of time, with an eye on distributive justice and an undivided focus on reduction in poverty. There is a link that ties these apparently disparate policy objectives; but these links need to be strengthened by deliberate government policy to make them fully functional.² It is only by achieving these connected objectives simultaneously or in quick succession that efforts to bring prosperity to humanity condemned perpetually to a life of drudgery and poverty can be crowned with success.³ The greatest minds in economics from Physiocrats to modern times have addressed this problem. Yet it remains an unfinished agenda of human existence--- equivalent to the mathematical problem of “squaring the circle”. It is, therefore, apt that the success of a set of development policies is judged by reference to the fulfilment or non-fulfilment of this universally valid amorphous objective---it is universally valid because it is a relevant reckoner regardless of state of development of a society. However, a successful pursuit of this agenda is a non-trivial exercise; but it is by no means impossible. In the last half a century, there are examples of the countries that have succeeded in weaving these elements of inclusive growth into a self-reinforcing process (South Korea, China, Singapore, for instance); and there are instances of failure (the Philippines, Mexico, Argentina). In each case of success, growth rate of per capita income has been kept high and stable. On the average, for the developing countries, there has been a negative relationship between growth and income distribution on the one hand; and between economic growth and poverty on the other hand---though around this average picture there is considerable variation. There is little doubt that the more equitable, widely shared and poverty-reducing growth is, the more sustainable it is likely to be. But there is no denying the fact that high growth of per capita GDP sustained over long periods of time leads the way in pressing forward with inclusive growth. But success depends on a full comprehension of the economic, political and ethical aspects of the issue; it also depends on the earnestness with which governments grasp the nettle ---governments, because leaving it to the market will not do. The governments must forge implicit or explicit social contracts with the people which are kept so that people voluntarily part with substantial amounts of savings to finance futuristic investments.⁴ In short, to sustain high growth rates over long periods of time the governments must move along the entire water-front, so to speak. It may be noted at the very outset that determining the size of the government has been one of the most wasteful academic pass-times and most damaging for development efforts. The basic point should be to focus on its effectiveness in terms of its success in ensuring inclusive growth.

The next section of this essay outlines the manner in which the problem of achieving inclusive growth in its multi-dimensional complexity has been tackled since 1950, when most developing countries got their independence from Western Colonial rule. To provide a perspective, the history of development policy in the West since the Industrial Revolution is also briefly recounted to see whether the policies pursued since Independence by the developing countries are a break from the past practices that made the Western countries rich and prosperous or are they a continuation of those practices followed by them since the Industrial Revolution? This essay subscribes to the latter view. To analyse this problem in greater detail we cite two recent works that try to address it. The first outlines the general historical account of the emergence of economic

² I first stated in great detail the above mentioned proposition in Naqvi (1992); and then in (1995); (2010). For a similar line of argument see also Bourguignon (2004) and World Bank (2008).

³ Thus, if inequality of income increases significantly relative to the increase in average per capita GDP, then it is possible for many people, especially those in the lower income group may be worse off even though average income is rising (Stiglitz, Sen, Fitoussi 2012, 3).

⁴ A concentration on the GDP statistic has been debated no end, and so has its implication for national welfare. We discuss briefly this problem in this paper; but hold the view that there is no other number as yet that summarizes the state of the economy in the form of a single number.

and political institutions since the Industrial Revolution in the West and elsewhere to sustain inclusive economic growth; while the second discusses the nature of the development policies adopted by Western countries to bring about Industrial Revolution and sustain it thereafter in their days of *underdevelopment*.

2. THE PURSUIT OF INCLUSIVE GROWTH SINCE THE INDUSTRIAL REVOLUTION

Acemoglu and Robinson (2012) present a historically rich account of development successes (and failures) of nations throughout the world. They maintain that inclusive growth on a sustained basis flows from a synergy of “inclusive” economic *and* political (democratic) institutions, which distribute political power broadly, and are essentially pluralistic and impose enough constraints on the abuse of political power by the elites. It ensures secure property rights for futuristic investment and spreads the fruits of development success to the widest proportion of a country’s population, gradually but surely. It also insists on the establishment of unbiased system of laws so that people live by law. Furthermore, it provides public services and allows freedom of making contracts with individuals of one’s choice. The interaction of inclusive political and economic institutions tends to generate virtuous circles of widespread prosperity and well-being. On the other hand, when political and economic institutions are out of synch and extractive, they create vicious circles of poverty, misery and ‘ill-being’. Both types of circles tend to be reinforcing and perpetuating, which are hard to reverse, so there is an element of historical determinism in the way that nations succeed or fail. But this is not the end of the story. Indeed, human volition and determined effort play a decisive part in shaping the destiny of nations. There are cases of countries, especially those which served colonial servitude, that succeeded in turning extractive economic and political institutions into inclusive ones (South Korea, for instance) and vice versa. The central idea here is that inclusive political and economic institutions nurture industrialization, fuelled by free-market competition, innovation and a process of creative destruction (one that destroys out-of-date production technology and replaces it by top-of-line technology), as Schumpeter (1954) pointed out long ago. However, creative destruction cannot come about if the political forces supporting the old methods of production are strong enough to block the forward march of a revitalized industrial process based on state-of-the-art methods of production. Anti-trust laws must, therefore, be enforced to foreclose such possibilities. However, the authors are careful to point out that they do not subscribe to free-market *ideology* that abhors *any* state intervention for the good of the society. Instead, they explicitly recognize that “inclusive institutions need and use the state” (Schumpeter 1954, 76).

Acemoglu and Robinson (2012) trace the origins of the inclusive institutions in what is now known as the First World to the Industrial Revolution of 1779 in England and before that to the Glorious Revolution of 1688, also in England, both of which had the effect of decentralizing economic decision-making. The French Revolution of 1789, which swept away the decadent *ancien regime*, also brought about a profound transformation of the economic and political structures in European societies. These historical “turning points” led to a consolidation of the inclusive political institutions by centralizing political power *and* making them truly pluralistic by diffusing it among the largest number of people. This process helped block the operation of what they call the Iron Law of Oligarchy--- namely, one that simply replaces one set of extractive political institution by another set of equally or even more extractive political institutions. In the two centuries following the Industrial Revolution, such a concatenation of political and economic forces, brought, about by unanticipated “small differences and contingency”, has favored the adoption of technological change in Western Europe and the USA. These institutional changes have been duly supported by mass education and the provision of health services to the masses.

Thus, it can be said that at least for 1/10th of humankind, located in the West, the ideal of inclusive growth has been pursued consistently and fruitfully, though of late there are factors that have undermined this process---for instance, the usurpation of the political process by corporate interests and the rising inequalities of income and wealth most pointedly in the US but in other OECD countries as well.⁵ The present essay broadly supports this analytical framework for assessing the sustainability of long-term growth and social justice in developing countries, but considers it to be an insufficient basis for formulating a sound development policy for inclusive growth. (To be fair to them, the authors *do not* recommend that their analysis is used for designing a policy “to encourage change towards inclusive institutions” [Acemoglu and Robinson 2012,

⁵ Two important studies bring out the phenomenon of rising inequalities in the US---Stiglitz (2012) and Noah (2012). Both point out a progressive concentration of power and wealth in the hands of the 1%---indeed, 0.1%---of the population in the US, while the rest continue to face extreme hardship. This has made capitalism dysfunctional and socially disruptive. Both conclude that remedial action needs to be taken before it is too late.

437).⁶ The reason is that the institutions necessary to conceive and deliver inclusive economic growth, depending as they do on unanticipated accidental and contingency factors cannot be replicated by calling into play these past events, some of which are of a once-in-a-century type of occurrences. Much less is it feasible to legislate and implement a development policy based on such accidents of history. However, the one solid idea they emphasize, and the one that this essay also singles out for detailed discussion, is the role of industrialism, supported by innovation and creative destruction, as holding the key to inclusive growth. The other study is one of the most honest accounts of why industrialism did not spread to the developing countries under Colonial rule---it is that the occupying powers did not *permit* the spread of Industrial Revolution to these unfortunate countries.

3. THE ENLIGHTENMENT ECONOMICS AND INCLUSIVE GROWTH

The nearly universally accepted wisdom about the Industrial Revolution's role in the creation and cementing of the inclusive economic political institutions is that it was an integral part of the essentially beneficial project known as European Enlightenment, which based human institutions and processes on rational thought rather than on religious superstition. And England and other European states which had adopted Industrial Revolution technologies practiced free-market, *laissez-faire* economics, based on their comparative advantage or disadvantage, keeping the government on the fringes of economic activity, though not out of it. Accordingly, the labor-surplus countries would produce labor-intensive agriculture goods (Portugal in Ricardo's example), and the capital-abundant countries capital-intensive manufactured goods (England in this example). If each trading country's productive resources were so organized, the returns to raw material producers and manufacturing producers would be the same and will be equalized across countries, and so would the wages to labor and the rental on capital, both relatively and absolutely. Thus both the production and distribution of income between capital and labor will be optimized, regardless of the commodities (agricultural or manufacturing) the trading countries produce. There would, therefore, be no need to change the production structure of either country, in particular by the agricultural country to import-substitute manufacturing, certainly not by government intervention. European Enlightenment based on *laissez faire*, free markets and minimum government, has thus been seen as a universal force for the good for both the labor-abundant and capital-abundant countries, both production-wise and distribution-wise.⁷

The key word in this study is also industrialism, regarded as the *only* way to achieve economic and political greatness. The focus however is on the *policies* that promoted it. Two key questions that it answers for the purpose of this essay are: Is it the case that industrialization within England and the big European states like France and Germany was promoted by free competitive markets, minimum government and *laissez faire*? And is it true that international commerce between weak and strong nations of Europe was conducted in an atmosphere of bonhomie and mutual goodwill? Contrary to common understanding, the answers to both questions are in the negative! Reinert (2012) in his wide-ranging study of the nature of Industrial Revolution in England, its spread to Europe and the US, and the general atmosphere in which trading relations were done, concludes that "Enlightenment" economics cannot be equated with *laissez-faire*, and "there is little heuristic value in continuing to equate, for good or bad, economic liberalism" with the "Enlightenment Project," whatever any of those phrases may mean"(p.283). It turns out that industrialization in England and in those European countries which were powerful enough to decide their economic policies was actively promoted by state intervention. Tariffs were selectively imposed to curtail international trade to "ensure the development of domestic productive capacity" (p.281). Not only that import-substituting industrialization at home was protected, but its fruits were not allowed to accrue to the weaker countries

⁶ Even for assessing the long-term possibilities, their prediction concerning China is unduly pessimistic. They predicts that Chinese growth "based on catch-up, import of foreign technology and export of low-end manufacturing products---is likely come to an end---and[its] spectacular growth rates will slowly evaporate"(p.442). This statement really sounds more like an anti-Chinese propaganda than a scientific statement. The spectacular growth rates are based more on the expansion of the domestic market by import substitution of a gradually higher order than on export fetishism and on an essentially balanced development of the economy. Its exports are not all that cheap either and have gradually moved to greater sophisticated exports of mechanical and electronics and computer-based products. Furthermore, the real reason for their pessimism, that China's political institutions will remain extractive, also rests on a rather primitive definition of democracy, based on elections and public balloting. For purposes of inclusive economic growth what is needed is deliberative democracy, one that allows public discussion of matters of concern for the people. This is happening in China through the TVE's, which have allowed much greater degree decentralization of decision-making than even in India. See, Bardhan (2011), and also footnote 16.

⁷ It is therefore not surprising that noble souls like Jacob Viner and Haberler have, for reasons stated above, fervently advised the developing countries, in the post-colonial times, not to fall for the guiles of industrialization in violation of the inviolable Law of Comparative Advantage---that is to continue in the footsteps of the Industrial Revolution that brought such prosperity to the West; and that any deviation from it would bring only the economic ruin of the Third World.

in Europe.⁸ He gives the tragic example of Naples, which tried to adopt English type “import-substituting industrialization” and had become the most industrialized state in Italy, but which was punished for this emulation by British gunboats to destroy these industries; to add insult to injury, Naples was made to pay heavy indemnities for hurting the British interests. He observes “ free trade simply meant England’s freedom to export manufactured in exchange for foreign raw materials, a practice oxymoronically known as “free-trade imperialism” (p.279). Indeed, this was the universal practice, designed to keep the late-comers from catching up with the pioneers, which meant England and few European countries which could take independent decisions. The law of comparative advantage was seen as a subterfuge to justify free-trade imperialism. Indeed, the example given above to prove the worth of the law of comparative advantage, called the crown jewel of economics, gave England the right to produce and export manufactured goods, and for the poorer Portugal the only option was to continue producing and exporting low value-added wine --- and to stay happy with that position ever after, because the price of unhappiness would be very high. The great German-American economist, Friedrich List (1844) summed up the widespread mood of frustration at the double-speak of the English economists in support of the beneficence of laissez faire: “It is a commonplace rule that when someone has attained the summit of greatness, he throws away the ladder by which he climbed up, in order to deprive others of the means of climbing up after him. Herein lies the secret of Adam Smith’s cosmopolitical teachings, the cosmopolitical tendencies of his great contemporary William Pitt, and of all their heirs in the British government administration”. (Cited in Reinert 2011, 43). Schumpeter (1954) echoed the same feeling much later when he characterized Ricardian theory as: “it is an excellent theory that can never be refuted and lacks nothing save sense” (p.473). As per this account the goal of inclusive growth was primarily meant to be pursued by and for the powerful states of Europe.

4. COLONIAL DEVELOPMENT POLICY AND NON-INCLUSIVE GROWTH

We now pass on from the West to the developing countries and see how the idea of inclusive growth was pursued under the long Colonial rule that these unfortunate countries had to serve. As one would expect in the light of the preceding discussion, Colonial policy was one of *enforced* non-development. It did not allow industrialism to prosper in the countries the same way it was done with the weaker nations of the West, with result that agricultural productivity in these countries was also kept low. Laissez faire and minimum government were the basic policy tools. Acemoglu and Robinson (2012) debunk the usual claims that colonial rule was in any way beneficial to the colonies. Indeed, the “the profitability of European colonial empires was often built on the destruction of independent polities and indigenous economies around the world-----” (p.271). Nearer home, the Indian textile industry which in the 18th century supplied textiles to the entire world was destroyed by the British to serve the interests of their textile industry. The spoliation of Africa was perhaps much worse and brutal. They cite these examples, as an explanation of “why industrialization passed by large parts of the world but also encapsulates how economic development may sometimes feed on, or even create, the underdevelopment in some other parts of the world” (p.273). Quite predictably, the result was a long period of static growth, high unemployment, poverty and misery in the colonies. As Reynolds (1983) points out, this period was marked by a total absence of the sparks of innovation and technological change. To put it bluntly, the quest for inclusive growth had all but been given up in the colonies. The wheel of economic progress was made to run in the reverse.

5. THE QUEST FOR INCLUSIVE GROWTH UNDER THE PIONEERS OF DEVELOPMENT ECONOMICS

Thus political and economic under-development was *the* problem facing development economists and policy makers at the time of Independence in 1950. The growth possibilities of the colonies at the time were considered too low.⁹ Fortunately, the development economists at the time of Independence knew their economic history very well; and had experienced first-hand the ravages of Colonial policy. One of the basic aims of the pioneers was, therefore, to increase the level of human well-being of the peoples living in the developing countries, in the shortest possible period of time. There was no way to achieve it except by reversing the Colonial development policies that had unambiguously retarded the growth and development of the developing countries for about a century or so. They knew that import-substitution industrialization helped by government protectionist policies was the *only* means to achieving prosperity and that the Invisible Hand of the market was just that, invisible! Under these inauspicious circumstances, to continue with laissez faire would tantamount to keeping them poor. At

⁸ In similar vein, Jacob (1997) has pointed out that the Industrial Revolution in England involved massive intervention by the state

⁹The best forecast for the long-term growth possibilities did not exceed 0.50% for India and Pakistan before their Independence in 1947. Things were no better for other colonies (Clark 1984).

any rate, any policy that gave the impression of perpetuating pre-Independence policies would have been politically unacceptable and those responsible for advocating such views would have been lynched as enemy agents.

Two basic ideas undergird the development policy at the time: namely, the ideas of Inter-sectoral Balance in the design of development and that of Structural Transformation. Both these ideas are described by the Lewis's two-sector model as set out in his Nobel Prize winning "Unlimited supplies of labor" article. The first idea was that to enlarge the domestic market and ensure a full utilization of the demand spill-overs from the industrial to agriculture sector and vice versa it was necessary to keep a dynamic balance between them. The general equilibrium economist that Arthur Lewis was, clearly saw that to industrialize without promoting agricultural improvements "is to ruin the industrialists (who won't have enough workers or consumers) and to improve agriculture without industrialization will ruin the farmers (who will live in a society with vast hordes of unemployed" (Cited in Tignor 2006, 87). The second element elaborated on the character of industrialism--- the process of the structural transformation of an agrarian society into an urbanized one---from a state of "cottage equilibrium to one of industrial equilibrium", and then it gradually moving from lower-order manufacturing to higher-order manufacturing. The basic idea here was to arrange for a steady transfer of less productive agriculture to industrial sector at a practically unchanged wage, indicating that even at the subsistence wage the supply of labor exceeded the demand for it. However, since the opportunity cost of labor would typically be significantly lower than the actual wages paid to it in manufacturing, the social return to employment in the manufacturing sector would typically tend to exceed private returns. The entire process of structural transformation may, therefore, have to be helped by state intervention for a pretty long time. Import substitution for both the domestic markets *and* the export markets, helped by innovation and technological change, was seen as the basic mechanism to achieve both elements of the development policy, noted above. In the long run it had the effect of raising exports as a percentage of GDP by diversifying the exports. It would be financed by a higher level of saving and investment that would be created in this process. However, it was emphasized that not only physical capital formation but also knowledge formation was central to this process. Indeed, Lewis in his (1955) classic isolated three factors---namely, the will to economize, the accumulation of knowledge and the accumulation of capital--- as holding the key to making a successful transition from a rural static state to an industrial dynamic state. The object of economic and social development was diagnosed as the fastest growth of per capita income by ever-rising rates of saving and investment and maximum employment generation to eradicate poverty as quickly as possible and to attain the high-income status of the rich countries in the foreseeable future. He also emphasized women's participation in outdoor economic activities as essential on economic as well as moral grounds. However, he and other development economists were clear that, to cite Lewis's maxim, "The horse of development should go in front carrying the cart of welfare behind it" (Tignor 2006, 37). But to harness the vast and complex potentialities of economic and human development, there was need for government-supported planned development. He emphasized that the newly independent countries will need "planning, planning and planning of the highest order" (Cited in Tignor 2006, 84).

This essay asserts that, rather than being a departure from historical practice, the development policies that the pioneers advocated was a sincere attempt to re-join the historical quest for inclusive growth. These policies were the same as those adopted by the dominant Western economic powers in the post-Industrial Revolution period, though the urgency of doing so facing the developing countries is greater, to make up for lost time under colonial rule. The leading development economists at the time had roughly the same understanding, as Reinert has, of the character of the Industrial Revolution and Enlightenment Economics.

Three points may be noted about the development policies of the time. Firstly, it should be clear from this summary statement of the pioneers' ideas that, contrary to the popular liberalist critique, they presented development economics not as an isolationist subject, having no connection with mainstream economics. These ideas, rather being heretical, were orthodox in that they represented a continuation of the development policies of the Industrial Revolution and Enlightenment Economics in terms of the basic underlying principles as well as the development policy that made it possible. As Tignor (2006) reports, both the basic ideas underlying Lewis's two-sector model---surplus agricultural labor financing Industrial development, and the emergence of an entrepreneurial class who would plough back their profits into greater investment---came from his reading of the factors contributing to the Industrial Revolution.

Secondly, while the development policy at the time represented a continuation of historical trend set by the Industrial Revolution in rejecting *laissez-faire* and using state intervention to implement import-substitution policies, it was truly cosmopolitan in outlook. While these policies were implemented by England in an isolationist manner, denying the weaker countries the greatness it achieved for itself; no such thing was evident in the attitude of the development economists and policy

makers. The basic ideas of development economics were universally adopted by all developing countries, big and small; and the development economists from all regions frequently exchanged views in an atmosphere of bonhomie on matters of common interest regarding the development policies for sparking and sustaining high and inclusive growth rates.¹⁰

Thirdly, these policies were essentially egalitarian in character. Although, Industrial Revolution was regarded by development economists as the high point of human ingenuity to transform static economies into dynamic economies, it was also clear in their minds that it would not be proper to copy Industrial Revolution's brutal methods. They knew that uncontrolled industrialism destroys happiness and well-being more rapidly than it creates it. So the emphasis was laid on *planning* for balanced development in an open economy, with ample resources devoted to education and social welfare programs.¹¹ However, all this could not be achieved without introducing basic reforms to abolish feudalism and to maximize women participation in paid outdoor work. Such reformist views came naturally to development economists like Arthur Lewis many of whom were Fabian socialists, who rejected both the liberalist prescription of the free- markets and the complete socialization of the means of production, as the communists demanded. Their reformist ideas were clearly aimed at ensuring fast economic growth with a modicum of social justice. Lewis, wrote: "The only long-term solution for [poor countries] was industrialization, which was possible---only if accompanied by a radical program of redistributing income from inordinately rich to the large number of impoverished"[Tignor (2006); p.45]. Furthermore, it was emphasized that such reforms could be achieved best within the framework of a pluralistic and democratic polity to make them truly inclusive. The emphasis has been on treating high rate of per capita growth, distribution of income and poverty reduction as an integral whole---to pursue inclusive growth, that is.

Development economists of the time sincerely believed that their ideas could bring about a peaceful transformation of the developing countries, eschewing class warfare. Indeed, these ideas with different degrees of emphasis in view of the local conditions were put in the form of blueprints for economic progress in Ghana and elsewhere in the newly liberated African countries. And it did not take too long to see their hopes fulfilled in the form of high rates of economic growth, industrialization and a more egalitarian development pattern by comparison with pre-colonial policies. Under the leadership of Raul Prebisch, Latin America celebrated its Golden Period of economic growth during the 1950 to 1980 period. Following similar policies, India laid solid foundations for future growth under the leadership of Mahalanobis and the modern fast growth of the Indian economy is based on these earlier policies rather being the outcome of free-market reforms. East Asia and now China have posted miraculous growth, never experienced at any time in human history. Africa too has experienced solid growth. Botswana has been the star performer here. Yet another example of fast growth is that of the war-ravaged Vietnam which has practiced similar development strategy. In all these cases (except perhaps Vietnam where poverty remains high) growth of per capita income has occurred with a reasonable degree of distribution of income and wealth ; and the incidence of poverty has been reduced dramatically wherever growth of per capita income has been consistently fast enough to double per capita income within a decade or so. Indeed, these ideas, wherever implemented conscientiously, changed those societies beyond the dreams of the founding fathers of the discipline of development economics. The founding fathers could not have dreamt of saving and investment rates exceeding 35 to 40% (the latest figure for China is 49%) of GDP and growth rates of per capita income breaking all the barriers of underdevelopment and smashing all the sticky vicious circles of poverty and human deprivation.

6. THE TRIUMPH OF THE LIBERALIST CREED OVER THE QUEST FOR INCLUSIVE GROWTH

One would have expected that in view of their spectacular *success*, the development policies pursued in the wake of Independence would win universal approval and would be pursued with greater zeal and with a greater understanding of the development process. But beginning in 1980 the most outré event happened.¹² With an unsettling suddenness, liberalist thinking "dethroned" the ruling development paradigm and replaced it by the so-called "first-best policies"---namely, minimal government, laissez faire and export fetishism based on the static principle of comparative advantage---in the belief that it

¹⁰For instance, Tignor (2006) reports that for discussing Ghana's Seven year Plan nearly all the prominent development economists in the West or the East---Lewis, Hirschman, K.N. Raj, N.C.Bos, Wignaraja and Ramanujan etc.---participated in an atmosphere of kinship and common concern.

¹¹ It is worth noting that all the international institutions like the GATT and the World Bank recognized the crucial importance of planned development at the time. In England, the Colonial Office, for which Lewis also worked, had accorded broad support to his ideas.

¹² Interestingly, the outbreak of liberalism in the developing countries coincided with the decline of Keynesian economics in the US and England. Alan Blander is quoted as saying: "by about 1980 it was hard to find an American macroeconomist under the age of forty who professed to be a Keynesian" (cited in Wapshott 2012, 268).

would also produce first-best (Pareto-optimal) results. In effect, this meant reversion to Colonial economic policies briefly reviewed above and the virtual abandonment of the inclusive growth ideal---all in the name of achieving static efficiency --- Pareto-optimality, that is.¹³ Development priorities changed drastically overnight, unrelated to development experience in the preceding post-colonial time.

The shift to liberalism in Europe began in response to the Keynesian rejection of the minimal government philosophy that regarded every government intervention a denial of free markets and as paving the road to state tyranny and serfdom. It also regarded every effort to establish social justice by redistribution of income and wealth an attack on human liberty. Under the leadership of Hayek, the Mont Perelin society was founded in 1947---including such luminaries as George Stigler, Milton Friedman, Lionel Robbins, Paul Volker, Fritz Machlup, Karl Popper, Frank Knight, etc.--- to safeguard the central values of civilization, to fight the decline in belief in private property and competitive market, to contribute to the preservation of free society (Wapshott 2011, 214).¹⁴ By its phrasing and content it began a crusade-type of movement to dismantle Keynesian thinking. These ideas assumed a quasi-religious dimension that could not be refuted by reference to their effects on the society. Initially derided, these ideas were adopted first by the British Prime Minister Thatcher under the influence of Hayek; and then by the US President Ronald Reagan who was deeply influenced by Milton Friedman. Both the economists had their differences but agreed that inflation was more dangerous than unemployment. Small government became a key word for policy-makers in both Britain and the USA, trusting private initiative more than government intervention. Monetary policy, to be implemented by the Federal Reserve Board, was considered as the more potent and relevant policy tool than fiscal policy, even to fight depression-like situations. Indeed, Friedman, in many respects the alter ego of Hayek in the US, 'proved' that Great Depression, which he called Great Contraction, "is a tragic testimony to the power of the monetary policy---not as Keynes believed testimony to its impotence" (cited in Wapshott 2012, 249). In other words, an economy deep in trouble needed, not a stimulation of effective demand as Keynes had advocated, but an adequate expansion of money supply. The emphasis on employment creation was replaced by keeping inflation rates at the lowest possible level, regarding the latter rather than the former as the economy's enemy number one.¹⁵ If the economic process led by market forces spelt sacrifices on the people, then these must be endured. The government interference with the market forces would tantamount to blocking the working of the natural laws of economics, which were held to be as immutable as all other natural laws. Even the nature of economic agents changed: from the masters of their own destiny, they were made slaves of the economic laws which were regarded as immutable as the natural laws. And, finally, a Nobel Prize for both Hayek and Friedman put a seal of academic virtuosity and scientific probity on these ideas.

It is, therefore, no wonder that the pioneer development economist's policies---namely, their denial of laissez faire as an oriflamme of international economic relations, their fervent advocacy of industrialization post-haste by government-sponsored programme of import substitution and their emphasis on egalitarian change in private property rights--- became the target of a virulent liberalist attack and vilification. Those ideas, rather than being regarded as helpful for economic progress, were held responsible for greatly compromising the growth possibilities of developing countries. Since they relied on heavy government intervention, they *must have* ruined these economies by definition, regardless of what the actual situation was. If the situation looked good on the ground, then it must be an illusion! Thus, for instance, if privatization did not increase competition but simply led to the creation of private monopolies, asset stripping and corruption on a massive scale -- of which there are examples aplenty --- then the remedy was more privatization, and yet more privatization. To take another example, if the free flow of short-term capital across national boundaries led to a contagion-like situation in East Asia in 1996-97, and made a sound exchange-rate policy impossible, they were still advised not to impose controls on them because a first-best policy cannot be violated. Assuming no significant trade-offs between the winners and losers from growth, the Liberalist Paradigm has consciously ignored equity-related reformist issue, because that would mean trampling over the individual's unlimited individual moral right to private property.¹⁶ This religious attachment to *procedures*, rather than to the *outcomes* of these policies, also explains why the liberalist attach overarching primacy to maintaining macroeconomic stability, which has been defined narrowly to focus only on low inflation rate, low budgetary and trade deficits as a percent-

¹³ Indeed, Lal (1983) in a popular book argued that Pareto optimality be adopted as a guiding principle of development policy!

¹⁴ The report from which the quotation in the text is taken was drafted by none other than the Secretary of the Society, Lionel Robbins.

¹⁵ For a comparison of the Hayekian and the Keynesian positions see Wapshott (2012); ch.3.

¹⁶ For a detailed discussion of the moral aspects of liberalist philosophy see chapter 9 of Naqvi (2010)

age of the GDP, and a “realistic” exchange rate.¹⁷ And yet contrary to their expectations, the net result of the liberalist iconoclasm has been to slow down economic growth, increase unemployment, increase poverty and widen the gap between rich and poor.¹⁸ Latin America, having experienced stellar growth for more than 25 years implementing the ideas of pioneers, had to serve more than 25 years of economic stagnation implementing the so-called first-best liberalist ideas, before emerging from it though rather at a slow rate. In sum, the search for the inclusive growth in the developing countries that had gathered momentum in the first thirty years of post-colonial period was either given a new meaning, or sacrificed altogether at the altar of macroeconomic stability. The solid lesson learned from development experience, especially that of the fast-growing developing countries, is that development cannot proceed over long periods in an atmosphere of macro-economic *instability*; but that valid concern is not a license for a one-sided pursuit of macroeconomic stability, no matter what. In general, the liberalists have not been wrong in emphasizing the need for macroeconomic stability; where they have gone sadly wrong is in focusing only on following certain procedures regardless of whether they produce the desired results--- whether they do succeed in laying down the preconditions of long term growth and also help the economy move beyond that to sustaining growth over long periods of time.

7. THE ANTI-LIBERALIST CONSENSUS

At the same time as the Liberalist Paradigm gained currency in the academia and led to a general decline of interest in development economics and policy, an important event was the evolution of ideas that challenge the neo-classical position on *laissez faire* and the undesirability of government intervention on any grounds. At the centre of this Consensus is theoretical literature that has made significant changes in the Arrow-Debreu version of neo-classical economics, by focusing attention on one of the key assumptions of the neo-classical model---namely, that information on both sides of the market is perfect and is cost-free. Under the leadership of Stiglitz and Akerlof, the Imperfect Information Paradigm has shown that with imperfect (and costly) information and incomplete markets competitive equilibrium is *not* generally *unimprovable*. There is whole industry of research that has made market success a rare occurrence, when not prevented by such real-life phenomenon as the presence of externalities, moral hazard, principal-agent phenomenon (involving cheating), public goods cases etc. Each of these phenomena creates immense policy space for Pareto-improving government intervention. Then there are studies that show that, contrary to the neo-classical and classical argument, unemployment is mostly involuntary, especially in circumstances like the Great Depression or more recently the Great Recession. Whence it follows that reducing the going (efficiency) wage rate would not necessarily improve market efficiency and create additional effective demand. Indeed, doing so is more likely to lower industrial productivity. Another set of studies showed that, in a dynamic context, when account is taken of dynamic external economies, static comparative advantage would no longer be suitable as a criterion for optimal resource allocation; nor would it optimize growth or social welfare. In practice, no developing country that made it to the fast-growers table has ever developed by the dictates of static comparative advantage--- neither in the West nor in the East. Instead, growth via industrialization creates its own dynamic comparative advantage, as it would be using decreasing cost technologies rather than the pre-industrialization constant-cost or increasing-cost technologies. An implication of this line of research is to turn one of the basic recommendations of the Liberalist Paradigm on its head and show that import substitution for both the domestic and the foreign markets, rather than export fetishism, would most likely lead to maximal growth---a point which history also confirms. Another development in the anti-liberalist vein has been studies that provided an analytical rendering of some of the basic ideas of the early development thinking --- namely, the Structural Transformation and the Big-Push hypotheses, and their distributive implications---are in fact of universal relevance and constitute a net addition to knowledge. They show that even on strict efficiency grounds, a government-led simultaneous industrialization program where demand spill-overs between sectors are significant, would be the only available option for the simple reason that individual acts of industrialization would not be possible under these circumstances.¹⁹ It is, therefore, surprising that these potent ideas which directly denied the relevance of the liberalist views on development policy have not undermined the zeal of the academic community for liberalist ideas even today.

¹⁷ The liberalist definition of macroeconomic stability is narrow, because a fuller definition of the term would also monitor, as any modern text on macroeconomics would show, the effect of the monetary, fiscal and foreign exchange rate policies on growth rates of GDP and the unemployment rate. The essence of public policy would then be to strike a balance between the monetary and real indices of macroeconomic stability.

¹⁸ Rodrik (2010) contains sharp criticism of the liberalist policies. Comparing these policies with those of fast growing countries like China, India etc. he remarks: “Given the policies in place in China, Vietnam and India, it is hardly an exaggeration that to say that it would have been easier to explain their performance if these countries had failed abysmally instead of succeeding the way they did.” (p. 86).

¹⁹ The ideas noted in the text are due to Murphy, Shleifer and Vishny (1989a,b).

8. THE HUMAN DEVELOPMENT PROGRAM AND INCLUSIVE GROWTH

Among other charges levelled against the inadequacy of the development policies of the formative years, one has been their alleged exclusive focus on the fastest possible increase of per capita income as the *sole* indicator of human well-being, neglecting non-income aspects of human well-being; and that it emphasized physical capital formation and not knowledge creation. Generally, the pioneers were accused of commodity fetishism and being not concerned with capability formation. The brief discussion of the pioneer's ideas presented in section IV above should be enough to reject these charges as ill-informed based on a cursory reading of the early development literature. And yet to deal effectively with what it calls human development-related issues, the UNDP-sponsored Human Development Paradigm has shifted the analytical and policy focus to a broader vision of human freedoms---one that allows individuals to make the choices they value most within the framework of an egalitarian and a democratic society that cares for human welfare and concentrates on enhancing social justice or minimizing, if not eliminating it. To this end, it claims to focus on the complex relationship between rationality, freedom and justice to get a complete view of human motivation. The edifice of this paradigm rests on strong philosophical foundations; and this in fact is its most original contribution to our knowledge. Sen (2010), a co-founder of this research program, points out that no less important than the actual achievements that a person ends up with is the *freedom* to choose among all the possible functionings that a person has. In other words, capabilities are not merely of instrumental value but the freedom to choose has intrinsic value, which a person cherishes. "The idea of capability---is oriented towards freedom and opportunities, that is the actual capability of people to choose to live different kinds of lives within their reach, rather than confining attention only to what may be described as the culmination---or aftermath---of choice"(p.237). So far so good.

However, problems arise in the application of these philosophical, elegant ideas to development-related issues; and when in particular we pass on to their concrete formalization in statistically measurable terms. As is well-known these are the ideas that undergird the new Human Development Index (HDI), which, since 1990, has been extended to adjust it to information about inequalities (IHDI) and the many other indices like the Multi-dimensional Poverty Index (MPI) that have been constructed to measure human happiness or unhappiness. By itself this information, published yearly by the UNDP in the Human Development Reports, is most invaluable in understanding the state of society's well-being or ill-being, and has gained international acceptability as a measure of human happiness. If nothing, it forces national governments to do better with respect to education and health, which are the non-income components of the HDI. It has also set in motion the search for a true set of indicator (or rather a set of indicators) of human happiness. However, going by the international acceptability, the same is true of the information on the growth rate of GDP per capita which is regarded no less than the HDI as an indicator of national health. It is still the most widely used criterion of economic performance, despite all the scepticism about it as a measure of human welfare. Countries falling behind in terms of growth rate and level of per capita income strive to better their record and try to converge to countries growing faster. The countries that have grown really fast and which have paid close attention to equity issues as well (e.g. South Korea, Indonesia, China) have achieved international recognition even more comprehensively than those which primarily improve their HDI record (like Sri Lanka, Nepal, Tunisia, Eastern Europe) but fell behind in growth terms. *HDR* (2010) duly notes that among the 10 top movers on the human development list, 7 are not high-growth countries. On the other hand, the fastest growing countries have also recorded definite improvements in terms of their HDI's. Thus, on the Spence (2011) list of the 13 top movers on the growth scale --- the Asian Tigers, Indonesia, Malaysia, Thailand, and Botswana, Malta, Oman, and Vietnam, India and Brazil--- are also the countries that led to miraculous human development achievements in a very short period of time. China which tops this list achieved wondrous income and non-income improvements.²⁰ Thus, it is more convincing to reduce poverty dramatically on a sustained basis by growing very fast (say at 6- 7% which doubles per capita income every 11 or 10 years) in an inclusive way (Naqvi 1995, 2010; Spence 2011, 54).²¹ In general, I show elsewhere that the support-led growth that the UNDP favors is not a substitute for what they call growth-mediated strategy of growth. Careful empirical estimation shows fairly convincingly that (i) a fast GDP growth lead to greater HDI improvements than the reverse chain of causation. Also, (ii) improvements in the former make a more decisive impact on poverty than the latter. And there is a solid economic sense in this sequence. It is that investment in human capital is required for its own sake but its effects on growth are more indirect and less obvious than those of physical capital formation. However, this is not belittling the importance of the human development program contribution to human knowledge. Furthermore, while it is absolutely correct to point out the inadequacy of the rate of growth of per capita GDP as the *sole* reflector of human well-being and to emphasize the need for statistical improvements to devise

²⁰Spence (2011) is essentially a formalization of the Report of the World Bank (2008).

²¹The latest report is that China has reduced poverty to only 2.3%.

multiple indices of welfare, doing all that is not necessarily an argument against pushing for the highest growth rate of GDP to improve the living standards of the people. The problem is not one of supplanting, but of supplementing the GDP measure with other relevant measures of human well-being to serve as a basis of an inclusive growth strategy. Experience shows that it is not enough to add to the supply of education but it is also essential to create a strong demand for it, which however comes from high growth.

All in all, it is fair to say that, for all its merits, the Human Development Paradigm does *not* focus on pursuing inclusive growth, as it has shifted the emphasis from achieving the fastest possible increase in the per capita GDP as its primary objective.

9. THE NEED TO CONTINUE SEARCHING FOR INCLUSIVE GROWTH

The brief survey of the evolution of development policy ideas since 1950 shows that what we have at present is a rather confused state of affairs in the realm of ideas with a cocktail of the liberalist agenda and the human development program running together; while the ideas of pioneers of development that did focus on inclusive growth have been rejected in academic literature on one false ground or another, even though these ideas continue to be practiced in high-growth economies, and there is a large body of theoretical literature that supports them. The analysis presented above should make it clear that the liberalist agenda has no relevance whatsoever to an inclusive-growth oriented development policy—indeed, it is anti-development. Even though its emphasis on macroeconomic stability is most welcome, since macroeconomic instability hinders growth and makes it unstable; yet it must face the charge of one-sidedness even on this count—that it has pursued its narrow agenda without regard to such basic objectives as growth, distributive justice and poverty reduction. Most of its anti-poverty programs end up by increasing it! The human development program, though philosophically impeccable, is not a sure guide to achieving inclusive growth on a lasting basis. Some of it is now agreed to even by the human development enthusiasts. And yet it is surprising that the UNDP keeps flogging the dead horse of the HDI versus the growth of per capita income controversy. Indeed, the HDR (2010) has unwisely sharpened it: “Human Development differs from economic growth in that substantial achievements are possible even without fast growth”(p.5).²² As a matter of fact, this is true; but it need not imply that pursuing the former is in some essence superior to the latter on the ground that achieving convergence with the West in terms of HDI is easier than in terms of growth of per capita GDP. As noted above, the focus should simultaneously be on achieving a creative symbiosis of the growth, equality and poverty reduction strategies within the framework of pluralistic political institutions that allow for decentralized deliberations and public reason, not just to have public balloting.²³ Broadly, the improvements in average standard of living should be combined with enhancing the quality of social justice (or minimizing social injustice), especially for the least-privileged in the society. The best way to do this is to abandon the vain search for one comprehensive indicator of human well-being, per capita GDP included. The proper thing to do is to evolve a framework that continues to use a revised GDP metric as a measure of market activity and then supplements it with additional information about the net changes in the quality of life of the people.²⁴ Indeed, as pointed out above, this is what the pioneers of development economics also recommended, though not so precisely in statistical terms. The net improvement on that position should be the addition of a wealth of new statistical information about the quality of life and a solid philosophical base to be able to make correct moral claims about the requirements of social justice, which the UNDP program provides.

²² While HDR (2010) duly recognizes the role of growth of income, yet it never recommends highest possible growth as a policy objective, or even as a means of achieving the desired capability expansion. For the latter it continues its emphasis on spending more on the non-income elements of HDI (p.6).

²³ The qualification in the text is important. As opposed to the traditional definition of democracy in terms of annual elections and free public balloting, the modern focus is on the content of democracy—that is what Rawls calls ‘the exercise of public reason’. He states clearly: “The definitive idea of democracy is the idea of deliberation itself. When citizens deliberate they exchange views and debate their supporting reasons concerning political questions” (cited in Sen 2010, 324). Thus, on this definition even the municipal councils or similar institutions that allow for extensive discussion and public questioning of the political institutions qualify as democratic institutions even where elections do not take place. This is however not an argument against elections which are of vital importance in themselves.

²⁴ This is also one of the key messages of the Report of the Commission the Measurement of Economic Performance and Social Progress: “These measures [about the quality of life], while not *replacing* economic indicators provide an opportunity to *enrich* the discussions and to inform people’s views of the conditions of the communities where they live” (Stiglitz, Sen and Fitoussi 2012, 62). [The italics are in the original]. With this position no reasonable person can differ.

10. RAINBOW'S END

It follows from the preceding analysis that the correct strategy to achieve inclusive growth is to restore the time-tested development policies that have brought prosperity to the teeming millions in an unbelievably short period time. In keeping with the tradition of Industrial Revolution, the developing countries, depending on their stage of development now, must be allowed to practice and subsidize import-substitution activity when needed---especially to find new areas of comparative advantage over the long haul. The fastest possible growth rates would require the smoothest possible process of Structural Transformation, which can be called as the Fundamental Law of Economic Development, both in the developed and the developing countries. However, this statement is subject to three important qualifications. Firstly, the statement above does *not* say that import substitution should be the *only* policy instrument to be used for encouraging industrialization, to the exclusion of export substitution. *It should be both.* In other words, the argument here is not for an inward-looking strategy, such as probably was the case in Latin America in the second phase of its development. Development experience has rejected export fetishism and as well as all-out import substitution. Indeed, as noted above, the aim is to increase the share of exports in GDP by diversifying so as to be able to import more to finance growth requirements. The aim is not to practice some kind of protectionism. What is being suggested is that the set of development-oriented policies should not be artificially narrowed by crowding out import substitution activities as economically sinful per se, because that would forestall long run growth and employment generation. Secondly, it also does not say that the *form* of import substitution should remain the same irrespective of the stage of development reached---it should gradually transition from simple manufacturing activities to more sophisticated activities based on science and technology, *while at the same time make provision for capital accumulation to sustain this process.* Protection should be removed from industries that have outgrown their infancy; and those which cannot sustain without protection, even after enjoying years of protection should be phased out.²⁵ Thirdly, the *form* of protection should also change keeping in view what is to be protected. It need not be import controls or differential exchange rates; it could take the form of subsidies given per unit of labor input, for instance.²⁶ The aim should be to expand the domestic market so that growth does not come to rely on exports alone. Yet there should be no confusion that industrialism must be in the driver's seat and *that it is only by achieving high rates of economic growth that inequality can be redressed without creating much social tension and poverty reduced dramatically on an irreversible basis.*²⁷ The aim of development policy should be to achieve and sustain high rates of growth of per capita income --- say 6% to 7% percent--- for several decades, duly supplemented by social safety nets and by universal access to education, including higher education (Naqvi 1995, 2010; World Bank 2008; Spence 2011). And to this end, industrialism, duly supported by a vibrant agricultural sector, should form the basic plank of a successful development policy. This is the *only* way to achieve inclusive growth on a sustainable basis. Following this historically correct path, some developing countries have already achieved the high-income status (like Japan, South Korea, and Singapore) and some others (China for example) are in the middle-income status within three decades, while others are poised to escape low-income vicious circle of poverty. The liberalist obsession with keeping inflation and budget deficit artificially low even at the cost of slowed growth and rising unemployment must be done away with, both on moral and economic grounds; and if only because slow growth and rising unemployment is a toxic combination that will undermine democratic societies.²⁸ Enforcing financial and monetary discipline is not a matter of implementing certain sure-fire rules that are visible enough to be seen by the naked eye. Experience of the developing countries suggests that it is useful to be modest here. That is, the definition and extent of this discipline lie within a large area of deliberate ambiguity, depending on the state of the economy, in particular. And, as Keynes observed long ago, "an unbalanced economy does not produce a balanced budget". The search for highest per capita growth should also not be sacrificed for the sake of achieving faster convergence in human development. High rates of human development are best achieved on a non-reversible basis

²⁵The success of South Korean great achievement is also due to this vigilance of the type of industries that need protection; and those which do not. This aspect has been discussed at length in World Bank (2008) and Spence (2011).

²⁶ There is a whole body of literature on the optimal forms of intervention in the presence of domestic distortions. This literature has been comprehensively reviewed in Bhagwati and Ramaswami (1963) and Naqvi (1969).

²⁷As opposed to the GATT, which recognized the legitimate needs of the development countries to practice import-substitution activities, the WTO responding to the interests of the West, forbids such activities.

²⁸Keynes in commenting on Hayek's book, *Road to Serfdom* which he liked otherwise, remarked: Hitler's rise was "facilitated not by big government but by the failure of capitalism and mass unemployment". He warned that: "if the US in peacetime returned to unemployment rates of the 1930's, then it may lead to political extremism that had drawn the world into war (Wapshott 2012, 199). These warnings are as true today as they were at the time that Keynes made them. Indeed, an unemployment rate of 9%---much lower than 30% or so in the Great Depression---has led to significant cause for concern for the population in a stable country like the US. What can happen, and is indeed happening in the much weaker developing countries, is not too difficult to imagine.

only when it comes on the back of highest possible growth rates. The long-term aim should be for all or most of the developing countries to move steadily to the high-income status and then compete among themselves and with the Western countries in a non-exploitative relationship---unlike the practices of powerful Western countries in the wake of Industrial Revolution. To generate light and not just heat, the key development debate should not be cast in the futile confrontational posture of this-versus-that--- namely, growth versus human development, government versus the market, agriculture versus industry, physical versus human capital formation, factor (input) accumulation versus productivity growth, export expansion versus import substitution, economic development versus human development etc. A successful development policy has to have some of all of these elements. It should look at these important matters in a “balanced” and practical way, keeping in view the stage of development already reached. Above all, it needs to be supported by an explicit government policy that keeps growth *with* equity as the primary objective of public policy. The element of time is of essence to keep the engine of growth running full throttle. Yet sustaining growth over long periods requires a strong sense of commitment to collective welfare, away from selfishness and greed focussed narrowly on one’s self-interest. To ensure the required supply of commitment, however, equality of opportunity is a must---that is, the state must ensure that all, men and women, get the same starting point in their lives---so that people know that if not they, at least their children and grandchildren will get a better deal as the economy scales greater heights of economic and social prosperity. Given that, some inequity in the distribution of income can be tolerated for some time, which is inevitable as labor moves from low-productivity rural activities to higher-productivity in manufacturing activities.

When the stakes are as high as they are in the developing countries--- most of the three-fourths of humankind still being denied an honored place on the table of successful nations---the unambiguous aim of development policy should be to internalize inclusive growth, where human freedom is incomplete without a compelling sense of sharing the fruits of economic progress with the least-privileged members of the society. The doctrine-less individualism, driven by a religious belief in selfishness and greed has done incalculable harm to modern societies. Holding a lantern across unimaginable opulence and abject poverty, development policy must emphasize giving rather than possessing. This is essentially what the search for inclusive growth amounts to.

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