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The Role of Social Policy in Economic Development

Some Theoretical Reflections and Lessons from East Asia

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Introduction

During the heady days of Neo-Liberal counter-revolution in the 1980s, the World Bank and the IMF prided themselves in not wasting their time on "soft" things like social policy in designing their "structural adjustment programmes". In the older, hardcore version of Neo-Liberal orthodoxy that had prevailed until the early 1990s, diverting resources to social policy, which softens the blow of the adjustment on the weaker sections of the society, was regarded as buying short-run palliatives at the cost of long-term productive development, as it can only slow down the necessary "adjustments". Many people remember how strongly this line of thinking was pursued during the 1980s. This was pursued to the point of producing a call for "adjustment with human face" by those who did not completely reject the need for structural adjustment programmes but were deeply concerned by what they saw as unnecessary human suffering caused by such programmes in their unadulterated forms (Cornia et al. 1987).

However, with the continued economic crises in many developing countries throughout the 1990s, and the failures of the Neo-Liberal "adjustment" and "reform" programmes to resolve such crises (many would in fact say that these programmes are actually one of the causes of these crises), even the World Bank and the IMF are now beginning to pay serious attention to social policy (Mkandawire 2001), provides an illuminating review of this shift). They now acknowledge that developing countries may need a "social safety net" to catch those who fall through the cracks in the process of economic "reform" based on their programmes. This shift in the attitudes of the part of the Bretton Woods institutions was, for example, manifest in the IMF programmes in the East Asian countries after the recent financial crises (Korea, Thailand, and Indonesia), where the Fund and the Bank put unprecedented emphasis on building "social safety network" devices.

The attention to social policy by the Bank and the Fund is most welcome. It is a positive development that they are now thinking about broader social consequences of their economic policies. However, there still exists a fundamental limit to their understanding of social policy. As the UNRISD has pointed out in a series of recent publications, the Bank and the Fund still view social policy as an essentially residual category of "safety net", and not as an essential ingredient in developmental strategy (Mkandawire (2001), succinctly summarises the UNRISD view).

However, social policy, if well designed, can be much more than a safety net and significantly contribute to productive development (for further details, see Chang 2002: ch.3). Cost-effective public provision of health and education can bring about improvements in labour force quality that can, in turn, raise efficiency and accelerate productivity growth. Social welfare institutions reduce social tensions and enhance the legitimacy of the political system, thus providing a more stable environment for long-term investments. Smoothing of consumption pattern through

devices like unemployment benefit can even contribute to dampening business cycle, which stabilises the macro-economy and thus encourage investments.

The present paper aims to elaborate on how social policy can be, and indeed needs to be, an integral part of a dynamic developmental strategy, by using the East Asian development experience as an example.

The choice of East Asia as an exemplar in this context may sound somewhat surprising, because traditionally East Asia has been regarded as "social policy free zone". Indeed, in the days before the Asian crisis, the apparent absence of social policy in the East Asian countries was often brandished as a proof that countries do well when they concentrate on economic policy and forget social policy. However, as we shall show later, this is a fundamentally mistaken characterisation of the East Asian developmental experience. The East Asian countries have used many policies and institutions to address "social" problems. The reason why many people think they have not used social policy is because many of the policies and institutions that they used in order to address "social" problems were *not* ones that are usually defined as "social policy" in the narrow sense. For this reason, looking at the East Asian experience can open up some new horizons in the discussion of the role of social policy in economic development.

The importance of "hidden" or "surrogate" social policies in East Asian developmental experience makes it necessary for us to engage in a theoretical discussion as to the validity of the customary distinction between economic policy and social policy before we look at the empirical evidence.

Economic Policy Versus Social Policy: A False Dichotomy?

As I have also implicitly accepted in my discussion in the introductory section, it is customary to distinguish economic policy from social policy. However, I would argue that in the final instance there cannot be a distinction between economic policy and social policy. Why is this?

The separation of economic policy and social policy implicitly assumes that it is possible to objectively define an economic sphere that should (and does) operate according to some "scientific" economic logic and a social sphere where we may want to (but are normally advised, by those "hard-nosed" economists, not to) over-ride the economic logic with "ethical" considerations (such as income distribution, employment creation, protection of human rights, etc.) despite the "inefficiencies" that such action is going to create.

This dichotomy is a useful fiction at one level, which I also use for some purposes. However, I think that it unduly constrains and ultimately misleads our research and policy agendas. I say this because I believe that, in the final analysis, there can never be such thing as an objectively definable economic sphere, neatly separable from other ("social" or whatever) spheres of life.

People usually assume that what goes on in the market belongs to the economic sphere and the rest in the social sphere. However, a market can be defined only with reference to the rights and the obligations of its (legitimate) participants, which in turn are products of various (conscious and unconscious) political decisions, and not some "scientific" law of economics. In other words, as Polanyi (1957) has so clearly shown, the market itself is a political (and social) construct, and therefore there cannot be such thing as neatly separable domain of "market" that is free from "politics" or "social concerns" (in the final analysis, this point is further developed in Chang (2001)).

To begin with, all markets are based on institutions that regulate who can participate. For example, laws may stipulate that certain types of individuals (e.g., slaves, foreigners) cannot own (certain types of) property or that children may own property but cannot exercise full property rights until they reach a certain age. Banking laws or pension laws may limit the range of assets that banks or pension funds own and therefore limit the range of asset markets that they can enter. Child labour laws, immigration laws, and laws regulating professional qualification (e.g., doctors, lawyers) dictate who can participate (or not) in particular labour markets. Company laws and industrial licensing rules will decide who can participate in the product market, while stock market listing rules and brokerage regulations determine who can participate in the stock market.

Second, there are institutions, which determine the legitimate objects of market exchange (and, by implication, of ownership). In most countries, there are laws illegalising transactions in things like addictive drugs, "indecent" publications, human organs, or firearms (although different societies have different views on what count as, say, addictive drugs or indecent publications). Laws on slavery, child labour, and immigration will stipulate, respectively, that human beings, labour service of children, and labour service of illegal immigrant may not be legitimate objects of exchange.

Third, even when the legitimate participants in and the legitimate objects of exchange have been stipulated, we need institutions that define what exactly each agent's rights and obligations are in which areas. So, for example, zoning laws, environmental regulations (e.g., regarding pollution or noise), fire regulations, and so on, define how property rights in land can be exercised (e.g., what kinds of building can be built where). For another example, the laws regarding health, safety, and grievance resolution in workplaces will define the rights and the obligations of the workers and the employers.

Fourth, there are numerous institutions that regulate the process of exchange itself. For example, there are rules regarding fraud, breach of contract, default, bankruptcy, and other disruptions in the exchange process, which are backed up by the police, the court system, and other legal institutions. Consumer laws and liability laws, for another example, will stipulate when and

how buyers of unsatisfactory or faulty products may annul the act of purchase and/or claim compensation from the sellers. Social conventions (e.g., those regarding fairness and probity) or codes of conduct issued by trade associations (e.g., bankers' association or industry associations) may also influence the way economic agents behave in economic transactions.

All the above-mentioned "regulations" that define the boundaries of the market (and thus of the "economic" sphere) are products of complex interaction between political bargaining, moral values, and technical considerations. And as the political bargains and moral values change, the legitimate boundary for the "economic" and "social" changes too.

Historically, what is regarded as the legitimate boundary of the economic sphere has changed tremendously. There are many things that used to be perfectly legitimate objects of monetary transaction but are not regarded as such any more. Public offices, the rights to collect taxes (tax-farming that was widely used among the European countries up to the 18th century), human beings (as in slave trade), the labour service of children (as in child labour), and so on were perfectly legal and politically legitimate objects of exchange in all societies in the past, but they are not so in many societies now (at least explicitly).

Many institutions defining the boundary of the "economic" sphere that we take for granted these days had been greeted with an outrage when they were first introduced. Although the languages used differed across cases, essentially their detractors saw those institutions that re-drew the boundary of the "economic" sphere as unwarranted imposition of "social" concerns on the sacrosanct "economic" domain. Let us illustrate this point with a number of examples (further details can be found in Chang (2000; 2002: ch.3)).

The most striking example in this regard will be the institution of self-ownership. This institution was obviously an anathema to slave-owners, and during the Civil War. Even many non-slave-owning Americans of the Southern states were willing to go to war in objection to the introduction of such institution, which they perceived as a grave threat to their states' economic (and by extension, political) freedom.[1]

The attempt to regulate, not to speak of banning, child labour was initially greeted with outrage by many people. For example, in the UK, in the debate surrounding the 1819 Cotton

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[1] It is well known that slavery was a key issue behind the American Civil War. However, it is less well known that this was not the only cause of the War. Another important cause was the disagreement on trade policy, where the South wanted free trade with Britain (so that they could buy higher quality British manufacturing products) and where the North wanted protection of their newly-emerging manufacturing industries. Some would argue that the "tariff" issue was in a way more important than the slavery issue in the sense that at least in the beginning of the War, Lincoln, who although objected to slavery thought the blacks racially inferior and regarded the abolition of slavery only as a theoretical possibility in a distant future, was quite willing to compromise on the slavery issue (he openly said that he did not want to impose slave emancipation upon Southern states that do not want it). However, no compromise was even proposed seriously on the tariff issue. See Chang(2002: ch.2) for further details.

Factories Regulation Act, which banned the employment of children under the age of 9 and restricted children's working hours, some members of the House of Lords argued that child labour should not be regulated because "labour ought to be free" (Blaug 1958).[2]

People showed even stronger reaction along the same line when the first attempts to introduce maximum working hours for the adults (especially adult males) were made in the now-advanced countries during the late 19th and the early 20th centuries). For example, in 1905, the US Supreme Court declared in the famous Lochner vs. New York case that a ten-hour act for the bakers introduced by the New York state was unconstitutional because it "deprived the baker of the liberty of working as long as they wished" (Garraty and Carnes 2000: 607).

When central banking was first introduced, the influential 19th century British political thinker, Herbert Spencer objected to it on the ground that it will encourage excessive risk-taking, because if the financial system gets into trouble, imprudent lenders as well as deserving ones will be rescued by the central bank. He argued: "(t)he ultimate result of shielding man from the effects of folly is to people the world with fools".[3]

Likewise, when limited liability was first introduced, many people regarded it as a deviation from a sensible economic principle. Commenting on late 19th Britain, Rosenberg and Birdzell (1986) document how even decades after the full-scale introduction of the principle of limited liability (although limited liability had been occasionally granted by royal charters, it was generalised only in 1855), small businessmen "who, being actively in charge of a business as well as its owner, sought to limit responsibility for its debts by the device of incorporation" were still frowned upon (p. 200).

The examples can go on, but the point that emerges from these discussions is the following (further examples can be found in Chang (2002: ch 3)). We seem to use the term "economic policy" as a short-hand for a policy whose underlying structure of rights and obligations is relatively uncontested (or, more likely, should not be contested according to the point of view of the person making the particular distinction) and "social policy" as a short-hand for a policy whose underlying

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