Markets, Inequality & Poverty

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Abstract

Can free markets contribute to eliminating inequalities and eradicating poverty? Proponents of free market economics claim that markets allowed to operate freely can lead towards the promotion of equity while opponents believe that markets on their own cannot bring about a just and equitable society.
The demise of the communist system in the late 80s led to the fall of planned economies and ascendancy of market economies. It marked the apparent triumph of capitalism. Capitalism as an ideology and market based economic policies emerged as the dominant orthodoxy in development.

Resume

The basic thesis of neoliberal economic policies is that the state is an inefficient and ineffective allocator of scarce resources. The market is seen as a better allocator.
These policies are predicated on the existence of free and perfect markets. Markets allow free entry and exit of economic actors. This facilitates market forces of supply and demand to determine prices. Economic actors respond to prices by exchanging goods and services leading to optimal efficiency. At this stage, resources are redistributed in society by an 'invisible hand' to meet the needs of the population.
The logic of markets is that economic actors are motivated solely by maximising utility.

Neoliberal economic policies derived from neoclassical economic theory state that growth in Gross Domestic Product (GDP) translates into poverty reduction. This growth is associated with rising productivity, new jobs and higher incomes. The new wealth created thus somehow 'trickles down' to the poorest members of society thereby improving their quality of life.

Zambia recorded positive growth rates in the 1990s following the introduction of neoliberal economic policies. However, poverty levels remain high and inequalities persist.

Introduction

The fall of the Berlin wall in 1989 marked a significant watershed in the theoretical debates between pro-market advocates and their detractors. The wall which physically separated East from West Germany marked the beginning of the end of communism. The downfall of communism in Eastern Europe marked the apparent triumph of capitalism. It led to the fall of planned economies and the dominance of market economies. Capitalism as an ideology and market based economic policies emerged as the dominant approach to development. This approach stressed the goal of economic activity as maximising utility on an individual level and profit on a corporate level. The ascendancy of market systems flourished during the reign of right wing political forces led by Ronald Reagan in the United States of America and Margaret Thatcher in the UK in the 1980s. The World Bank and the US Treasury at the time were avid promoters of market reforms. These forces espoused an ethic that placed a high premium on methodological individualism.

Theory and Practice

Proponents of the self-regulating market systems argue that when rational human beings act out self interests and seek to maximise profits without restraint society benefits from their endeavours.[1] They augment their arguments by referring to the failed economic theories, policies and practices of the now defunct Soviet system.[2]

However, the capitalist system itself has experienced some challenges, notably the East Asia crisis in the late 1990s and more recently the Global Economic Crisis of 2008. Both events have raised questions about the efficacy of markets to deliver on development. The supremacy of the market as a mechanism to enhance wealth, reduce poverty, eliminate inequalities and promote development is now in doubt. This has brought to the fore the debate between the supporters of the market who regard the market as the best tool to allocate scarce resources and those who oppose them. In recent times it is a debate that has pitted the so-called ‘finance’ advocates and the civil society advocates.[3]

This paper argues that markets are necessary to promote growth but not sufficient to eliminate inequalities and eradicate poverty. It begins by defining the terms used in the paper. It will then relate to the recent history of Zambia as a case study that demonstrates that the neoliberal economic paradigm has failed to reduce neither poverty nor narrowed inequalities. Finally, it will state that an anthropology based on the Catholic Social Teaching (CST) is helpful in restoring the right order of human relations within a market paradigm.

Markets, poverty and inequality

Markets

In this paper markets are defined as spaces, physical or otherwise that facilitate interaction of agents who are willing and able to exchange goods and services. They are institutions that bring about a redistribution of goods and services in an economy.[4]

The logic of the market is that wealth can be allocated efficiently by impersonal market forces to members of any given community. Liberal economists assume that when the market is left to itself then its inherent self-direction will govern its operations efficiently and produce efficient outcomes.[5] This implies that when self-interested individuals enter the market and pursue their own goals of maximising utility, then somehow an ‘invisible hand’ will ensure that their combined efforts work to the general benefit of everyone.[6]

Inequality

Inequality in this paper is understood as the differences that exist in society in terms of income and consumption. Inequalities then refer to the disparities that exist in society in terms of income and the distribution of wealth.[7]

Poverty

Four approaches to the definition and measurement of poverty have been developed. Poverty is defined in terms of the income, capability, social exclusion and participatory approaches.[8]

A common method of defining poverty is the income method. It uses a given threshold in terms of US dollars that is required for a decent standard of living.[9] It defines poverty in terms of a shortfall in consumption.[10]

The capability approach pioneered by Amartya Sen suggests that poverty is '…the deprivation of basic capabilities rather than the merely lowness of incomes … ' Sen suggests that the expansion of human capabilities should be employed to determine human well-being.[11]

The social exclusion concept refers to a process through which people are excluded from full participation in the society to which they belong. The final approach developed by Robert Chambers gained widespread use in the poverty debates within the World Bank.[12] The World Bank characterizes this way of understanding poverty as 'voicelessness and powerlessness.[13] This refers to the inability of people to influence processes and development programmes to impact positively on their actual life situation.

Markets are promoted as the best instrument in allocating resources efficiently and effectively.[14] This follows Adam Smith comment that the 'hidden hand' of the market converts individual interests into the wealth of the nations'[15] It is frequently stated that getting 'prices right' is the pathway to growth and prosperity.[16] Actors in the market respond to prices in the market.[17] The ascendancy of liberalization following the collapse of planned economies has given rise to the neoliberal orthodoxy that posits markets as the best mechanism for achieving growth and reducing poverty. The free operation of the market will spur on entrepreneurs and private investors to enter the market, promote competition, improve efficiency and thereby raise incomes. Inequalities will disappear and poverty eradicated. For such a process to succeed requires little government intervention and neutral incentives to motivate individuals to interact freely in the market place.[18]

Neoliberal economic policies derived from neoclassical economic theory hypothesise that establishing markets and providing a laissez faire environment leads to increased productivity. This increase will yield increased incomes and raise the standard of living for all concerned. This implies that the solution to high levels of poverty and wide inequalities lies in increased economic growth. In the initial stages such growth may not be sufficient to wipe out inequalities pace but eventually with long term sustained growth such inequalities will disappear and poverty levels will fall.[19]

Application to Zambia

Since 1991, Zambia has been implementing neoliberal economic policies following the election of right wing leaning government. The introduction of market reforms followed an economic crisis in the 1980s, growing out of an inefficient economic system, decline in copper prices and a protracted drought.[20] The Zambian government instituted market oriented reforms that entailed reducing subsidies, privatizing government owned firms and liberalizing the trading environment. These reforms formed part of the so-called 'Washington Consensus' a raft of economic reforms sponsored by the World Bank, the IMF and the US Treasury. The goal was to replace State intervention in the economy and allow markets through the private sector to drive the economy.

Zambia is one of the poorest countries in the world. 64% of its population lives below the poverty threshold while 51% live in extreme poverty.[21] It is ranked 164 out of 182 countries on the Human Development Index.[22] It is also considered to have high inequalities amongst its population[23] Statistics show that Zambia has one the highest Gini coefficients in the world, with the latest figure standing at 50.8[24]. The latest government review on the performance of the Fifth National Development Plan indicates that in 2006 the Gini coefficient representing income distribution was as high as 60.[25]

The transition to a market oriented economy took the form of structural adjustment programes (SAPs) in 1991. SAPs were intended to arrest a declining economy that had been in free fall since the mid 1970s. Market reforms will restore efficiency, stimulate growth and ultimately improve the quality of life of the Zambians. The introduction of market reforms was expected to lead to greater equity.[26] At the time up to 71% of the population was classified as poor.[27]

In terms of poverty levels, a reduction from 71% to 64% was achieved between 1991 and 2009. However, in terms of inequality, Zambia remains a very unequal society. The 2006 Living Conditions Monitoring Survey shows that 50% of the population earns 15% of total national income while 10% of the population earns 48%.[28]

The implementation of neoliberal economic policies through SAPs did not immediately yield the kind of economic growth that would reduce poverty levels significantly. Even though Zambia achieved some stability following the introduction of a market economy and scored growth rates of around 5% over several years, nonetheless inequalities remain high as indicated by the Gini coefficient. The notion that growth will lead to poverty reduction and equity has not matched the neoclassical economy theory in the case of Zambia. The so called ‘trickle down’ effect has hardly touched the majority of Zambians.

The prediction of neoclassical economic theory that the action of self-interested individuals pursuing maximum utility in a market system would lead to the improvement of the general welfare of a population[29] has yet to produce improvements in the quality of life of Zambians. The expectation that high and sustainable growth will automatically translate into poverty reduction.[30] has not occurred 20 years after neoliberal economic policies were introduced in Zambia.

This link between poverty reduction and increased productivity is the preferred approach of the neoclassical economists.[31] Poverty can be eliminated if market forces are unleashed to do what they do best, induce growth and the growth will culminate in more incomes for everyone concerned. This will translate into a more equitable society with ease access of the citizens of the country to the basic needs essential for survival. However the evidence in Zambia does not fit the theory.

Surveys conducted by the Jesuit Centre for Theological Reflection (JCTR) since 1996 show that the cost of living for the majority of Zambians has been on a steady rise while the corresponding income levels have not risen to match the cost of living.[32] The evidence adduced above supports the theory that neoclassical economic theory and its attendant neoliberal economic policies do not in all cases lead to sustainable development. Sustainable development in this sense is seen as enabling many more citizens of a country to enjoy a high quality of life. Neoliberal economic policies which further the free actions of market forces to spur on development have yet to show convincing evidence that the growth leads to equity.

Neoclassical Economic Theory and Poverty Reduction

Neoclassical economic theory assumes that a given rate of growth of GDP translates into poverty reduction. Increases in GDP in any given country represent the best route towards lifting people out of poverty. Such growth maybe accompanied by rapid rates of industrialization giving rise to new jobs, increasing incomes and improving the living standards of the poor.[33] According to this line of thinking growth occurs when market forces are allowed to determine the prices of different products on the market to stimulate productivity and innovation. Consequently, a self-regulating market economy responding to price signals is able to stimulate economic activities driven by supply and demand forces to ensure that economic actors pursue self interests that culminate in economic growth. Narrow economic interests are primary and no other considerations are allowed to play a part in economic endeavours.

Neoliberal economic policies believe that the State is an inefficient and ineffective actor in allocating scarce resources. The assumption is that the market is a better instrument at allocating resources.[34] Neoliberal economic models are predicated on the existence of free and perfect markets. These markets allow free entry and exit of economic actors into the market. This facilitates market forces to play the role of determining prices and consequently allocating resources according to the dictates of supply and demand.[35]

The logic of markets embedded in neoclassical economics is predicated on the assumption that economic actors are motivated and solely preoccupied with maximizing utility. Consequently an economy can only reach optimal efficiency when there is no attempt to regulate self-interested economic actors. This kind of economics would go so far as to posit that those who are poor and unemployed have failed to take advantage of market opportunities to earn a livelihood.

In its purist form classical and neoclassical economic theory does not have a place for poverty alleviation programes particularly the type that are undertaken by the State. Neoclassical economists see poverty reduction efforts as slowing down growth.[36] This in some ways explains the neoclassical economists' antipathy towards the State's intervention in the economy. For neoclassical economists the market is superior to the State in resource allocation and therefore the latter should be limited in its interventions in the economy.

Market fundamentalists are obsessed with growth. Growth comes from the entrepreneurial activity of a rational economic actor operating in an enabling environment. There is no questioning that growth is necessary for development and that markets can play an important role in facilitating this growth. However, growth for its own sake is not a sufficient condition for development and poverty reduction. What is crucial is to recognize the limitations of both the State and markets in development activities.[37] The State, however, can play a meaning role in limiting or even compensating for market failures. Perhaps the basic question that can be asked is 'What can government do best?.[38]

Neoclassical economic theory fails to take into account the fact that markets can experience failures. For markets to work efficiently several conditions need to occur such as perfect information, unhindered entry and exit into the market, perfect competition just to mention a few. Seldom are many of these conditions met. Consequently, market failures are common particularly in Low Development Countries.[39]

It has been frequently stated that the market is a good servant but a bad master.[40] Left to itself it cannot guarantee the integral development of every human being. What is required is to harness the good side of the market, as represented its ability to generate wealth, and reject its bad side which is seen mostly in its unintended effects such as increase in inequalities. Neoclassic economic theory with its attendant methodological individualism places a heavy premium on a rational actor pursuing self-interest in a bid to maximise material well-being. This displays a reductionist world view where everything is reduced to economic interests. This effectively rules any other way of conceiving human well being.

A flawed vision of the world

Neoliberalism's worldview revolves around material concerns. The basic quest for rational beings is to achieve as much material success as possible. When human beings are given the freedom to pursue their private interests aided by the price mechanism society benefits from increased growth of the economy[41] Their anthropology is founded on the notion that human beings are solely preoccupied with the pursuit of economic self-interest. This vision of the world is flawed. It is purely a mechanistic worldview that gives too much responsibility to the market to address the society's challenges.

Much of the conflict between the proponents and opponents of the market stems from differing ideological positions. The former have received backing from conservative political forces believe that society's challenges can be resolved by strengthening the rights of individuals to pursue individual interests. Conservatives who espouse capitalist approach to economic activity believe that negative freedoms such as the right to non-interference to economic actors to participate in economic affairs should be strengthened in order to enable the fruits of such endeavours to 'trickle down' to the rest of society. On the other hand, civil society perspectives that the rights of individuals should be matched with their corresponding duties to aid the collective should be retained and promoted. The market cannot assure these rights only the State can guarantee them.

The goal of development from a neoliberal point of view is to increase the nations' GDP. The higher the GDP the more prosperous the country is reckoned.[42] However, GDP misses many aspects of our existence. Besides, much of the progress in important areas of life is invisible to most people.[43] The neoliberal paradigm simply promotes the materialistic motivations of individuals.[44]

Ethical Concerns

The main normative aspect of neoliberalism is the promotion of individual achievement and protection of negative rights[45] Right wing political forces in the 1980s and early 1990s at the time of the hegemony market economy economic theories supported such approaches. However, as Allen and Thomas point out that social forces such as solidarity and other non-market forces play crucial roles in improving the living standards of the people.[46] This would be in sharp contrast to the moral voice of the Church which encourages the promotion of social values.

Commenting on the crisis that beset the capitalist world in 2008, Frank Turner wonders whether part of the problem of the Global Economic Crisis could not be ascribed to the absence of ‘a moral or systemic crisis’.[47] It surely can be argued that the absence of ethical and moral consideration did play a part in the Financial crisis that engulfed much of the Western World in 2008. The greed and irresponsibility exhibited by some economic actors in these financial markets played a critical role in its unravelling. Neoclassical economic theory would consider this normal as part of the motivating factor of ‘rational self-interested’ economic actors.

Ethical and moral concerns are important in the Christian approach to interactions in the market place. The Church Social Teaching is clear on the need to promote ethical values such as solidarity, the common good and a special concern for the poor[48] The economy and by extension the market should serve the interest of those who are weak and unable to actively take advantage of the market to advance their economic and material interests. The market cannot guarantee this facilitate. And free markets cannot work in a moral vacuum.[49] The State who primary responsibility is to promote the common good is expected to supplement the actions of the market. Such goods as shelter, health care, education, transport and welfare cannot be left to the market[50]

Civil society groups who oppose the self-regulating market in development activities point to similar concerns. As a practical example, the JCTR, a faith based organisation that engages in research, advocacy and education has always advocated for a value based approached to development endeavours. It employs the CST to call for the respect of human dignity and the promotion of human rights as a holistic approach to development. Such an approach recognises that the market on its own cannot deliver on development. The market is amoral and needs moral input to ensure that the ‘trickled down effect’ reaches all corners of society. Free markets need appropriate political direction to ensure that the goods of the earth are enjoyed by all its inhabitants.

Conclusion

The preceding sought to suggest that the theoretical assumptions underpinning the neoclassical economic theories are flawed. Neoliberal models of development advocated by pro-market fundamentalists in the 1980s and 1990s failed to lift the vast majority of people out of poverty. Such policies promoted by International Financial Institutions (IFIs) such as the World Bank and the IMF have done very little to significantly reduce poverty and narrow existing inequalities.

CSOs including the church have been advocating a tempering of the push for market oriented reforms in order to less the adverse impact of neoliberal economic reforms.[51]

This essay attempted to show that different ways of perceiving the world yield different ways of intervening to bring about positive social change. A neoliberal worldview sees social change in terms of increasing aggregate wealth which then is redistributed by inhuman market forces to bring about a convergence in living standards between the rich and the poor. This way of perceiving the world has been found wanting. Economic growth does not necessarily lead to poverty reduction and declining inequality. The evidence adduced above suggest that in some cases economic growth does very little to change existing poverty situation and inequalities. Neoliberalism with its stress on individual action as a precursor to group welfare has not fared well in Zambia. Much of the failure of neoliberalism can be located in its universalist pretensions of what works in one place can work everywhere. The one –size fits all approach has now been discredited even though the fall of communism appeared to give a thumbs up to capitalism. In recent times, the once derided economic planning has made a comeback and the State has been reinstated in order to curb the excesses of the market and strengthen the distributive dimension of human well being.

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