Economic Development - The Human Nature Constraint - Part I

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This series of articles is intended to stimulate discussion concerning a shortfall in attempts to resolve the current global economic crisis. The thesis presented is that in our current context, development is no longer ultimately constrained by the unavailability of Land, Labour and Capital, but rather by the prevalence of tragic flaws in human nature. For this reason, economic dialogue needs to evolve beyond bailouts, austerity and jumpstarting consumerism, to seriously addressing the concern, "How do we tackle the human nature constraint?"

For more than half a century, the development debate has stumbled from theory to theory in search of a sustainable formula that triggers development and manages it in a way that does not unjustly exploit the society, or the environment. Unfortunately, the theories explored have consistently been grounded in unrealistic assumptions concerning the competitive economy and market-led growth, particularly understating the impact of the [1]human nature issues (i.e. principal-agent problems). Leaders have buried their heads in a neo-liberal vs government intervention debate, prescribing solutions that deny the real issue, which is that the root of the crisis is not financial.

For the purpose of this article, we will define sustainable development as discretionary development that seeks to satisfy the needs and aspirations of the present, while safeguarding the ability of future generations to satisfy their own. In Part I, we will familiarise ourselves with the neo-liberal and government intervention debate, and the term principal-agent problem. Part II will use case studies to uncover the root causes of the current financial crisis in order to

[1] Referred to as "principal-agent problems" in academic circles.

identify their link to flawed human nature. We will conclude by asking ourselves, “What should be our leaders’ number one priority?”

The neo-liberal debate is rooted in the theory that competitive markets regulate themselves. The supporting rationale is that the pursuit of self-interest, in a regulated environment, is optimal for allocating resources, whether physical, natural, human or financial. Therefore, under the neo-liberal agenda, privatisation, liberalisation of markets, tax reform and deregulation are promoted as the drivers of innovation and efficiency in an economy. Meanwhile, the role of the State is to create the institutional framework in which competition will flourish that is, strong private property rights, free markets and free trade. In summary, the neo-liberal agenda transfers economic control from the State to the market with the expectation that the market will shepherd resources in the way necessary for the attainment of self-sustained economic growth and production.

The neo-liberal agenda has robust theoretical merits, particularly with respect to the role of competition. Arguably, many failures, especially following the economic crisis of the 1970s and 1980s, were due to unsuitable implementation of the agenda in developing economies. Decision-makers had neglected to properly address two crucial concerns:

1. *Has this economy acquired the stage of development that is required to sustain a neo-liberal growth process?*
2. *How can the agenda be fine-tuned to make it more suitable for this context?*

If these questions were addressed prior to implementation, the Structural Adjustment Programmes would have been more relevant to the respective economy, and likely more successful. Anyhow, that is a separate issue, let us move on.

Government intervention is any action taken by the government that alters or changes economic activeness, the ability to supply, or the decisions made through normal market trade. The debate for government intervention is based on the assumption that markets will fail if left to regulate themselves. Market failures are instances when goods and services are not allocated efficiently or equitably, due to factors, such as pockets of ignorance in the marketplace (i.e. information asymmetries), [2]non-competitive operations, principal-agent problems, or the "spill-over" effects upon innocent by-standers to market activity (i.e. externalities). Due to the current economic crisis, the debate in favour of government intervention has gained strength.

At present, it may be postulated that the prime factor behind market failure is the principal-agent problems. A *"principal-agent relationship"* describes the interaction between the hirer and the hired. The principal hires the agent to perform a service on his behalf, for example, an individual may hire a lawyer to represent him at a court appearance. Or, citizens in a nation hire a government to represent their best interests, while managing the affairs of the land. Conflicts in the principal-agent relationship generally arise under the following conditions:

1. The agent's actions are driven primarily by self-interest, rather than the interest of the principal
2. The agent has more information than the principal (this is the condition of information asymmetry)
3. The principal is unable to monitor the activities of the agent.

The prevalence of these conditions at the firm level is what resulted in the collapse of Lehman Brothers and Enron, and at the country level, Greece. We will address these as our case studies.

Now that we have familiarised ourselves with the main terms, the context is set for some case study analyses in Part II. What will be revealed is the disturbing nature of current government intervention strategies, which only skim the surface of the deep-seated regulation and transparency issues, while ploughing funds right back into the faulty market. This activity is comparable to parents posting bail for delinquent children, and then, without due attention to discipline, sending them back into society, with the hope that the invisible hand will steer their lives in the right direction. The result?...Billions of dollars are being inhaled by a market-led

[2] These refer to monopolies, oligopolies and elements of unfair advantage

vacuum, while leaders keep their fingers crossed, hoping for a simple twist of fate, but let us not jump ahead of ourselves…stay tuned for Part II

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