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The Great Escape from Global Poverty

The Economic and Moral Case for Good Management

By Walker Wright, MBA

Poverty has been a moral issue at the center of philosophical, theological, and social thought for millennia.[1] However, over the last two centuries, much of the world has experienced what Nobel economist Angus Deaton calls "the great escape" from economic deprivation.[2] As a 2013 issue of *The Economist* explained, one of the main targets of the United Nations Millennium Development Goals (MDG) was to halve extreme poverty between 1990 and 2015. That goal was accomplished years ahead of schedule and the credit largely lies with one thing:

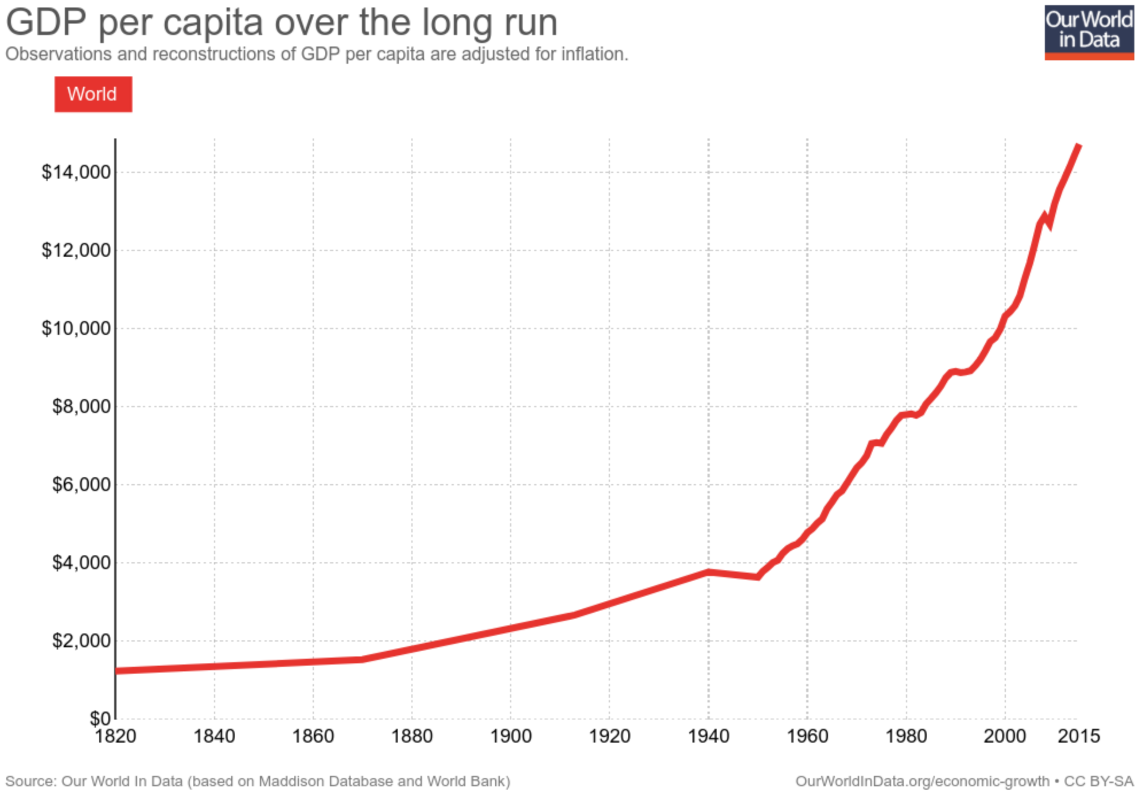
> The MDGs may have helped marginally, by creating a yardstick for measuring progress, and by focusing minds on the evil of poverty. Most of the credit, however, must go to capitalism and free trade, for they enable economies to grow—and it was growth, principally, that has eased destitution.[3]

Worldwide Economic Growth Eases Poverty

If this economic narrative is to be believed, then managing well is even more important in the fight against poverty. Research over the last decade finds that management—the day-in, day-out processes of everyday business—*matters*. As this article will show, economic growth has lifted billions of people worldwide out of extreme poverty via pro-growth policies (especially trade, property rights, and moderate government size). Good management, in turn, plays a significant part in this growth by increasing total factor productivity (TFP) and could therefore be considered a pro-growth policy. In short, those in management positions have the potential to improve the well-being of the global poor by learning to manage *well*.

Figure 1

Growth & Poverty: The Greatest Story Never Told



Roser, Max. "Economic Growth." OurWorldInData.org (2017); https://ourworldindata.org/economic-growth (Used with permission.)

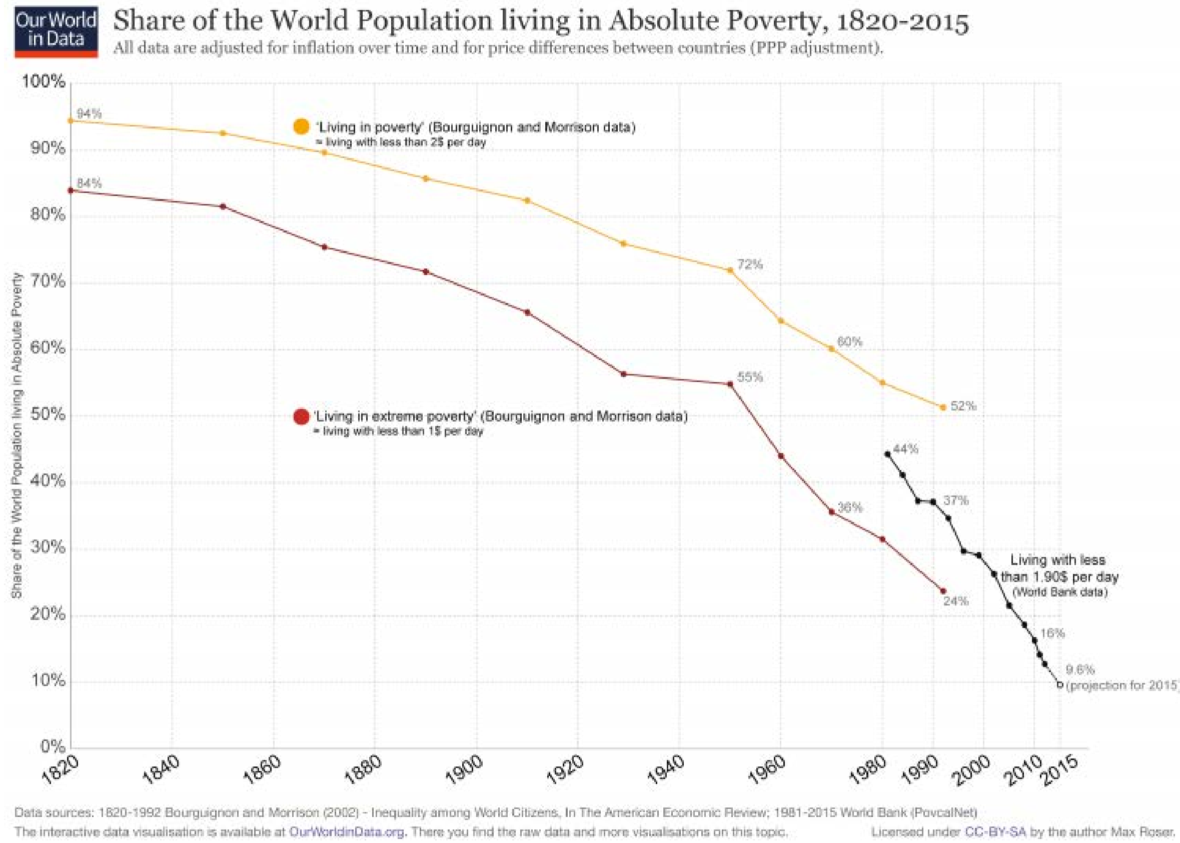
First and foremost, it is pertinent to demonstrate the overall impact that economic growth has on the least well off. The graph above displays the enormous gains for the average person that economic growth has generated over the last 200 years. According to Noel, Smith, and Webb:

> Across the whole sweep of the 1800s and 1900s, annual income growth per person averaged more than 1.5 percent in Europe and more than 1.7 percent in the United States…Expressed in contemporary values, the average income in the United States went from approximately $1,980 in 1820 to 2000's $43,200. These stupendous increases in incomes drove the dramatic improvements in physical well-being that we modern citizens take for granted.[4]

Noel, Smith, and Webb add that this kind of growth can be achieved if governments "craft economic institutions that reward all types of investment in physical and human capital, and that help markets function securely and inexpensively."[5] The explosion in economic activity over the last two centuries has decimated extreme poverty worldwide, bringing it to its lowest levels in human history.[6]

Figure 2

Share of the World Population Living in Absolute Poverty, 1820-2015



Roser, Max and Ortiz-Ospina, Estebana. "Global Extreme Poverty." OurWorldInData.org (2017), https://ourworldindata.org/extreme-poverty/ (Used with permission.)

According to the Brooking Institution's Laurence Chandy and Geoffrey Gertz, this worldwide economic improvement is due to

> …the rise of globalization, the spread of capitalism and the improving quality of economic governance—which together have enabled the developing world to begin converging on advanced economy incomes after centuries of divergence. The poor countries that display the greatest success today are those that are engaging with the global economy, allowing market prices to balance supply and demand and to allocate scarce resources, and pursuing sensible and strategic economic policies to spur investment, trade and job creation. It is this potent combination that sets the current period apart from a history of insipid growth and intractable poverty.[7]

Their 2011 study also argued that poverty has declined so rapidly that the MDG goal of halving the rate of global poverty was likely met three years prior to their report.[8]

Using a sample of 92 countries over a 40-year period, economists David Dollar and Aart Kraay found that "growth-enhancing policies and institutions"[9]—including openness to international trade, low inflation, moderate size of government, financial development, and strong property rights and the rule of law—on average increase “the income of the poor to the same extent that it increases the income of the other households in society.” These pro-growth policies “create a good environment for poor households—and everyone else—to increase their production and income.”[10]

Increased Global Trade

As noted, globalized trade has played a critical role in boosting economic growth and reducing extreme poverty worldwide.[11] For example, Andreas Bergh and Therese Nilsson examined data from 114 countries between 1983 and 2007 and concluded that the relationship between poverty and globalization is both negative and significant. Lower trade restrictions and higher information flows in particular are associated with lower poverty levels.[12]

A 2010 study used data from 131 developed and developing countries and found that reductions in trade protections led to higher levels of income per capita.[13] A World Bank study found that between 1950 and 1998:

> …countries that liberalized their trade regimes experienced average annual growth rates that were about 1.5 percentage points higher than before liberalization. Postliberalization investment rates rose 1.5–2.0 percentage points, confirming past findings that liberalization fosters growth in part through its effect on physical capital accumulation…Trade-centered reforms thus have significant effects on economic growth within countries.[14]

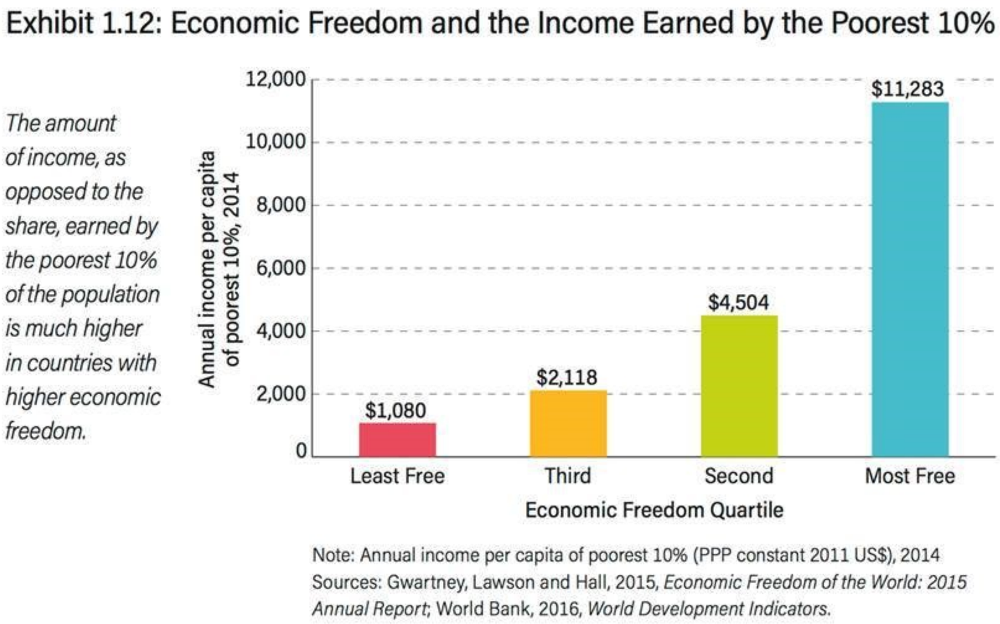
Perhaps most important, according to Fajgelbaum and Khandelwal, recent evidence finds a “pro-poor bias of trade in every country.*”*[15] *This kind of evidence is why free trade has such overwhelming support from professional economists.*[16]

Impact of Economic Freedom

The Canada-based Fraser Institute publishes its oft-cited *Economic Freedom of the World* report annually. Its indicator—known as the Economic Freedom of the World (EFW) Index—defines economic freedom based on five major areas: (1) size of the central government, (2) legal system and the security of property rights, (3) stability of the currency, (4) freedom to trade internationally, and (5) regulation of labor, credit, and business. According to its most recent report (which looks at data from 2014), countries with more economic freedom had substantially higher per-capita incomes and economic growth. However, one the most important findings is the level of income earned by the poorest 10 percent of the population between various countries. The poorest 10 percent in the countries that fell in the “most free” quartile earned over *ten times* that of the poorest 10 percent in the “least free” countries.[17]

Figure 3

Economic Freedom and the Income Earned by the Poorest 10%



Gwartney, Lawson, Hall, 2016, pg. 27. (Used with permission.)

Economist Joseph Connors compared the impact of economic freedom, democracy, and foreign aid on global poverty between 1980 and 2005. Drawing on the EFW Index mentioned above, Connors found that a one unit increase in the average level of EFW over the 25-year period led to an 11.41 percentage point lower extreme poverty rate in 2005. In comparison, democratic institutions had little impact on poverty, while foreign aid had virtually none.[18]

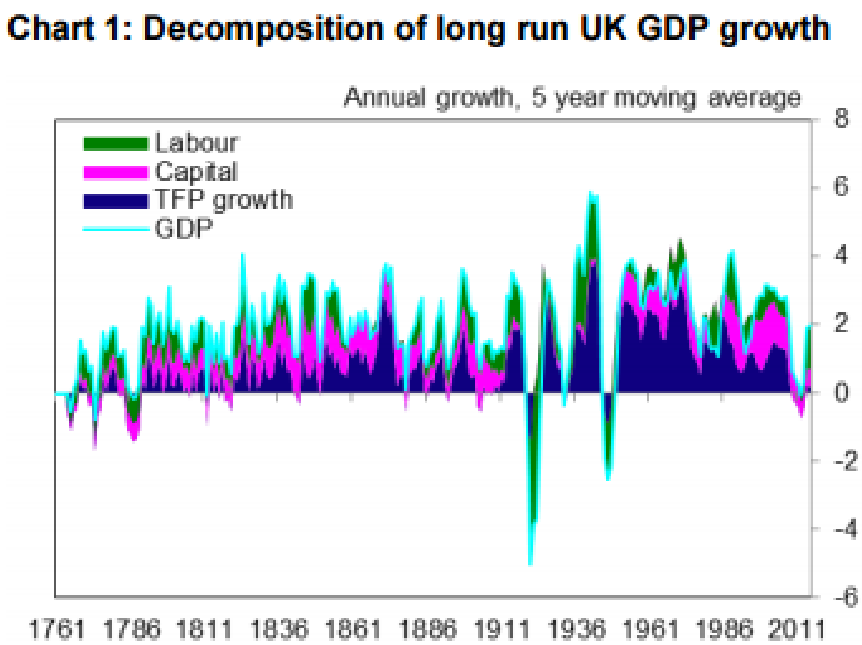
Harvard's Andrei Shleifer has shown that during the same period, world per capita income grew about 2 percent per year. During these 2.5 decades, serious hindrances on economic freedom *declined*, including the world median inflation rate, the population-weighted world average of top marginal income tax rates, and the world average tariff rates.[19] "In the Age of Milton Friedman," summarizes Shleifer, "the world economy expanded greatly, the quality of life improved sharply for billions of people, and dire poverty was substantially scaled back. All this while the world embraced free market reforms."[20]

These various policies and conditions have been highlighted because of their empirical connection to economic growth. What this literature should establish is growth's ability to lift the poor out of poverty and improve the lives of the destitute. If economic growth is the answer to poverty, then—to quote Dollar and Kraay—"growth-enhancing policies should be at the center of any effective poverty reduction strategy."[21]

Total Factor Productivity

Paul Krugman once famously said, “Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker.”[22] Harvard’s Greg Mankiw writes, “Almost all variation in living standards is attributable to differences in countries’ productivity[.]”[23] Diego Comin finds that when economic growth is broken down into contributions from labor, capital, and improved efficiency, one finds that growth is largely driven by Total Factor Productivity (TFP): “the portion of output not explained by the amount of inputs used in production,” the levels of which are “determined by how efficiently and intensely the inputs are utilized in production.”[24] As economist Andrew Haldane put it, “movements in TFP have accounted for the lion’s share of both the growth and variation in living standards [in the UK] since at least the mid-18th century.”[25]

Figure 4
Decomposition of Long Run UK GDP Growth



Haldane, 2017, pg. 21. (Used with permission.)

Figure 5

Total Factor Productivity Correlates with Per Capita GDP, 2000

FIGURE 1. Per capita GDP and TFP between countries. US = 1. Source: Jones and Romer (2010).

Bloom *et al.*, 2014, pg. 838. (Used with permission.)

Good Management Matters

Recent research has found that when it comes to a nation's TFP—and, consequently, its economic growth—*management matters*. As McKinsey's John Dowdy and LSE economist John Van Reenen explains that their research shows:

> …that the core elements of management can be assessed and scored and that well-managed firms have higher productivity, market value, and growth, as well as a greater ability to survive adverse conditions, such as global financial recessions. Our research further indicates that more than 80 percent of all productivity variation occurs within a given sector for a given country and that there's a "long tail" of persistently badly managed firms in all countries and across all sectors. These findings suggest a significant potential for management-led productivity improvements in every country on Earth.[26]

In a number of publications spanning the last decade,[27] Stanford's Nicholas Bloom and colleagues have narrowed down three essential elements of good management:

1. **Targets**: Organizations must set proper short-term benchmarks for long-term goals, track the outcomes, and respond appropriately if the two are inconsistent.
2. **Monitoring**: Organizations must monitor the on goings within the firm and analyze this performance data to continuously improvement.
3. **Incentives**: Organizations must reward and promote employees based on performance, engage in careful hiring, retain talent, and retrain or remove underperformers.

These management practices account not only for large cross-country differences in TFP, but within country differences as well. In fact, one standard deviation increase in management quality leads to a 15 percent increase in firm TFP.[28] The United States has the highest average management score, followed by Japan, Germany, and Sweden. This tends to translate into higher productivity, firm size, profitability, sales growth, market value, and firm survival.

On average, management accounts for nearly 30 percent of the TFP gaps between the U.S. and other countries.[29] The significance of management varies from country to country. For example, management practices make up about half of the TFP gap between the U.S. and Portugal, but only 1/10 between the U.S. and Japan.[30] Bloom, Lemos, Sadun, Scur, and Van Reenen note, "Management can potentially account for a great deal of the TFP spread within countries. In the United States and United Kingdom about a third of the 90-10 difference in TFP can be related to management practices."[31]

An excellent example is the IT-led productivity boom among U.S. multinationals after 1995. According to Bloom and colleagues,[32] the reason European multinationals did not experience the same kind of boom was in part due to the United States' superior people management. When all of this evidence is considered, it becomes increasingly clear that poor management could quite literally be holding the economies of developing countries back.[33]

Figure 6

Higher Management Scores Correlate with Higher TFP

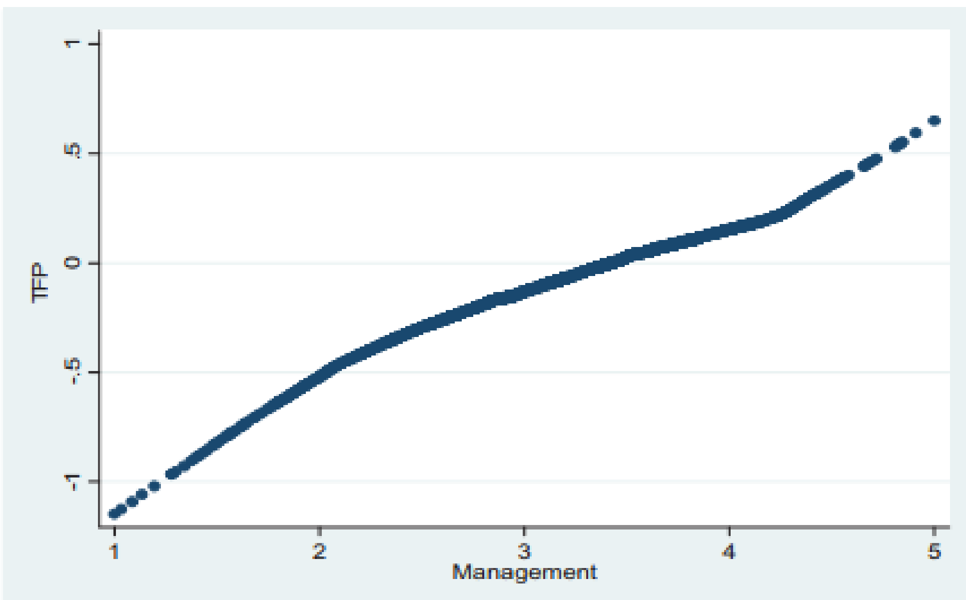


FIGURE 13. TFP is increasing in management. Management is an average of all 18 questions (set to sd = 1). TFP residuals of sales on capital, labor, skills controls plus a full set of SIC-3 industry, country, and year dummies controls. $N = 8{,}314$. Source: Bloom, Sadun, and Van Reenen (2013a).

Bloom *et al.*, 2014, pg. 856. (Used with permission.)

The empirical literature suggests that proper management makes serious contributions to TFP. Therefore, management could be considered a "growth-enhancing" policy. But management practices do not just matter for manufacturing or run-of-the-mill firms. Higher-quality management can lead to higher survival rates in hospitals,[34] better educational outcomes in schools,[35] reduced days to treatment for clients of substance abuse treatment programs,[36] and better performance in research and teaching at universities.[37]

Ethics Pays

In contrast to the occasional narrative of business being inherently exploitative and immoral, it turns out that productivity-boosting management practices are also *ethical* in nature. As Linda Treviño and Katherine Nelson lay out in *Managing Business Ethics*—ethics pays.[38] One example is the value of a good reputation among stakeholders. They write:

> In general research has supported the idea that having a good reputation pays off in lower costs, higher sales, and the ability to charge higher prices than firms with poor reputations can. Studies have also found that workers are more attracted to firms with a reputation for social responsibility…Once employed, people are also more committed to organizations that have a "benevolent climate"—one that focuses on the welfare of employees and the community, while organizational commitment is lower in "egoistic" climates (based on self-interest and people being out for themselves).[39]

Illegal and unethical behaviors are costly. Not only do they accrue legal fines, but market share loss and decreased stock prices due to the hit to the firm's reputation. In addition, unethical conduct often leads to more government regulations.[40] Research by Marty Stuebs and Li Sun finds that reputation is linked to improved labor efficiency and productivity.[41]

Social Responsibility

Evidence from the U.S. chemical industry suggests that corporate social responsibility (CSR) activities can lead to higher future productivity.[42] This indicates that ethical management inadvertently contributes to TFP. These findings complement previous research that finds "that firms can strategically engage in socially responsible activities to increase private profits. Given that the firm's stakeholders may value the firm's social efforts, the firm can obtain additional benefits from these activities, including: enhancing the firm's reputation and the ability to generate profits by differentiating its product, the ability to attract more highly qualified personnel or the ability to extract a premium for its products."[43]

Conclusion

In her Bourgeois Era trilogy, economic historian Deirdre McCloskey argues that the "Great Enrichment" over the last couple centuries is due to the changed attitudes toward the *bourgeoisie*—the professional class. Beginning in 17th and 18th century Europe, commerce, business, and innovation became seen as respectable and dignified.[44] Perhaps the findings above call for a reevaluation of management's place in the world as well. What this brief overview demonstrates is:

- Economic growth via pro-growth policies (e.g., trade, property rights, etc.) raises living standards and decreases poverty.
- TFP plays a primary role in economic growth.
- Good management significantly boosts TFP.

Based on these three premises, it seems fair to conclude that proper management can indirectly, but materially benefit the poor and needy around the globe. This can offer encouragement to businesses to revamp their current management practices not only for profit, but to improve the lives of those in poverty. In turn, knowing they can make a significant difference can inspire the profession of managers to learn how to manage *well*.

About the Author(s)

Walker Wright, MBA, graduated from the University of North Texas with an MBA in Strategic Management and a BBA in Organizational Behavior & Human Resource Management. He has been published in SquareTwo, BYU Studies Quarterly, and Dialogue. His online writing can be found at the blog Difficult Run. He lives in Denton, TX, with his wife.

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[1] For example, biblical scholar Bruce V. Malchow points out, "Most [biblical] interpreters are agreed today that Israel received its concern for social justice from the Near Eastern cultures surrounding it. In fact, protection of the poor, widows, and fatherless children was a *common policy in the [ancient] Near East*" (*Social Justice in the Hebrew Bible: What Is New and What Is Old*. Collegeville, MN: Liturgical Press, 1999, 1; emphasis mine).

[2] Deaton, A. (2013). *The Great Escape: Health, Wealth, and the Origins of Inequality*. Princeton, New Jersey: Princeton University Press.

[3] *The Economist.* (2013). "Toward the End of Poverty." June 1. Accessed at http://www.economist.com/news/leaders/21578665-nearly-1-billion-people-have-been-taken-out-extreme-poverty-20-years-world-should-aim

[4] Noell, E. S., Smith, S. L.S., & Webb, B. G. (2013). *Economic Growth: Unleashing the Potential of Human Flourishing*. Washington, D.C.: AEI Press, p. 6.

[5] Ibid, p. 29.

[6] Unfortunately, a 2014 Barna survey found that 84% of Americans are unaware that extreme poverty worldwide has decreased by more than half in the past three decades. Sixty-seven percent said they thought global poverty was actually *increasing* over the last 30 years. Similarly, a 2016 survey found that the majority of respondents from several countries were unaware that global poverty had been declining over the last 20 years. See "Global Poverty Is on the Decline, But Almost No One Believes It." Barna Group. April 28, 2014, https://www.barna.com/research/global-poverty-is-on-the-decline-but-almost-no-one-believes-it/#.VyG2MTiYbmU; Lampert, M., & Papadongonas, P. (2016). *Towards 2030 Without Poverty: Increasing Knowledge of Progress Made and Opportunities for Engaging Frontrunners in the World Population with the Global Goals* (Amsterdam: Glocalities, 8. Available at http://www.glocalities.com/reports/towards-2030-without-poverty.html.

[7] Chandy, L., & Gertz, G. (2011). "With Little Notice, Globalization Reduced Poverty." *Yale Global Online,* July 5, http://yaleglobal.yale.edu/content/little-notice-globalization-reduced-poverty. See also Potrafke, N. (2015). "The Evidence on Globalisation," *The World Economy* 38 (3), pp. 509-552.

[8] Chandy, L., & Gertz, G. (2011). "Poverty in Numbers: The Changing State of Global Poverty from 2005 to 2015." *Global Views*, 18. Brookings Institution, Jan. Accessed at https://www.brookings.edu/wp-content/uploads/2016/06/01_global_poverty_chandy.pdf

[9] Dollar, D., & Kraay, A. (2002). "Growth is Good for the Poor." *Journal of Economic Growth*, 7 (3), pp. 197. See also Dollar, D., Kleineberg, T., & Kraay, A. (2016). "Growth Still is Good for the Poor." *European Economic Review*, 81, pp. 68-85.

[10] Ibid, p. 219.

[11] See Bhagwati, J., & Srinivasan, T.N. (2002). "Trade and Poverty in the Poor Countries." *American Economic Review*, 92 (2), pp. 180-183; Dollar, D., & Kraay, A. (2004). "Trade, Growth, and Poverty." *The Economic Journal*, 114 (493), F22-F49. Aisbett, E., Harrison, A., and Zwane, A. (2008). "Globalization and Poverty: What is the Evidence?" in *Trade, Globalization, and Poverty*, ed. Elias Dinopoulos, Pravin Krishna, Arvind Panagariya, & Kar-yiu Wong. New York: Routledge.

[12] Bergh, A., & Nilsson, T. (2014). "Is Globalization Reducing Absolute Poverty?" *World Development*, 62, pp. 42-61. Their follow-up study found that globalization reduces poverty *especially* when the country's institutional quality is weak. See Bergh, A., Mirkina, I., & Nilsson, T. (2016). "Do the Poor Benefit from Globalization Regardless of Institutional Quality?" *Applied Economic Letters*, 23 (10), pp. 708-712.

[13] Manole, V., & Spatareanu, M. (2010). "Trade Openness and Income—A Re-examination." *Economic Letters*, 106 (1), pp. 1-3.

[14] Wacziarg, R., & Welch, K. H. (2008). "Trade Liberalization and Growth: New Evidence." *The World Bank Economic Review*, 22 (2), p. 212.

[15] Fajgelbaum, P. D., & Khandelwal, A. K. (2016). "Measuring the Unequal Gains from Trade." *The Quarterly Journal of Economics*, 131 (3), p. 1116.

[16] According to Greg Mankiw, 93% of economists agree with the following statement: "Tariffs and import quotas usually reduce general economic welfare." For the figure and sources, see Mankiw, G. (2015). *Principles of Economics*, 7th ed. Stamford, Connecticut: Cengage Learning, p. 32.

[17] "Economic Freedom of the World in 2014." (2016) *Economic Freedom of the World: 2016 Annual Report*, James Gwartney, Robert Lawson, & Joshua Hall (eds.) Fraser Institute, p. 25-27.

[18] Connors, J. (2011). "Global Poverty: The Role of Economic Freedom, Democracy, and Foreign Aid." Ph.D. dissertation, Florida State University, pp. 32-33.

[19] Shleifer, A. (2009). "The Age of Milton Friedman." *Journal of Economic Literature*, 47 (1), pp. 125-126.

[20] Ibid, p. 126.

[21] Dollar & Kraay, 2002, p. 219.

[22] Krugman, P. (1997). *The Age of Diminished Expectations: U.S. Economic Policy in the 1990s*, 3rd ed. Cambridge, Massachusetts: MIT Press, p. 11.

[23] Mankiw, G. (2015). *Principles of Economics*, 7th ed. Stamford, Connecticut: Cengage Learning, p. 13.

[24] Comin, D. (2008). "Total Factor Productivity," in *The New Palgrave Dictionary of Economics*, 2nd ed., Steven N. D., & Lawrence E. B. (eds). New York: Palgrave Macmillan, p. 329.

[25] Haldane, A. G. (2017). "Productivity Puzzles," Speech given at the London School of Economics, March 20, p. 2. Accessed at http://worldmanagementsurvey.org/wp-content/uploads/2017/03/boespeech_220317.pdf. He cites Hills, Thomas, & Dimsdale (2016) "Three Centuries of Data–Version 2.3." Accessed at http://www.bankofengland.co.uk/research/Pages/datasets/default.aspx.

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[27] This section draws heavily on the following selected works: Bloom, N., Van Reenen, J. (2007). "Measuring and Explaining Management Practices Across Firms and Countries," *The Quarterly Journal of Economics*, 122 (4), pp. 1355-1408. Bloom, N., & Van Reenen, J. (2010). "Why Do Management Practices Differ across Firms and Countries?" *Journal of Economic Perspectives*, 24 (1), pp. 203-224. Bloom, N., Genakos, C., Sadun, R., & Van Reenen, J. (2012). "Management Practices Across Firms and Countries." *Academy of Management Perspectives*, 26 (1), pp. 12-33. Bloom, N., Sadun, R., & Van Reenen, J. (2012). "Does Management Really Work?" *Harvard Business Review*, 90 (11), Nov. Accessed at https://hbr.org/2012/11/does-management-really-work. Bloom, N., Eifert, B., Mahajan, A., McKenzie, D., Roberts, J. (2013). "Does Management Matter? Evidence from India." *The Quarterly Journal of Economics*, 128 (1), 1-51. Bloom, N., Lemos, R., Sadun, R., Scur, D., Van Reenen, J. (2014). "The New Empirical Economics of Management." *Journal of the European Economic* Association, 12 (4), 835-876. Bloom, N., Sadun, R., & Van Reenen, J. (2016). "Management as a Technology." IZA Discussion Paper No. 9987, June.

[28] Bloom et al., 2014, p. 855.

[29] Bloom et al., 2016, p. 23.

[30] Bloom et al., 2014, p. 862.

[31] Ibid.

[32] Bloom, N., Sadun, R., & Van Reenen, J. (2012). "Americans Do IT Better: US Multinationals and the Productivity Miracle." *American Economic Review*, 102 (1), pp.167-201.

[33] Bloom, N., Schweiger, H., & Van Reenen, J. (2012). "The Land That Lean Manufacturing Forgot? Management Practices in Transition Countries." *Economics of Transition*, 20 (4), pp. 593-635. Lemos, R., & Scur, D. (2012). "Could Poor

Management be Holding Back Development? Describing Practices in the Public and Private Sectors in India." International Growth Centre Working Paper, November.

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[36] McConnell, K. J., Hoffman, K. A., Quanbeck, A., & McCarty, D. (2009). "Management Practices in Substance Abuse Treatment Programs." *Journal of Substance Abuse Treatment*, 37 (1), pp. 79-89.

[37] McCormack, J., Propper, C., & Smith, S. (2014). "Herding Cats? Management and University Performance." *The Economic Journal*, 124 (578), F534-F564.

[38] Treviño, L. K. and Nelson, K. A. (2014). *Managing Business Ethics: Straight Talk about How to Do It Right*, 6th ed. Hoboken, New Jersey: John Wiley & Sons, Inc., pp. 334-344. You can find a nice summary of their findings (with hyperlinks) at http://www.ethicalsystems.org/content/ethics-pays.

[39] Ibid, pp. 334-335.

[40] Ibid, pp. 335-339.

[41] Sun, L., & Stuebs, M. (2010). "Business Reputation and Labor Efficiency, Productivity, and Cost." *Journal of Business Ethics*, 96 (2), pp. 265-283.

[42] Sun, L. and Stuebs, M. (2013). "Corporate Social Responsibility and Firm Productivity: Evidence from the Chemical Industry in the United States." *Journal of Business Ethics*, 118 (2), pp. 251-263.

[43] Hernandez-Murillo, R., & Martinek, C. J. (2009). "Corporate Social Responsibility Can Be Profitable." *The Regional Economist*, April, 17 (2), p. 5.

[44] See McCloskey, D. N. (2006). *The Bourgeois Virtues: Ethics for an Age of Commerce* (Chicago, Illinois: University of Chicago Press. McCloskey, D. N. (2010). *Bourgeois Dignity: Why Economics Can't Explain the Modern World*. Chicago, Illinois: University of Chicago Press. McCloskey, D. N. (2016). *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World*. Chicago, Illinois: University of Chicago Press.