

assigned to governments was one of a "benevolent social guardian."⁴³ This was an erroneous characterization, since persons in the public sector often act in their own self-interest, just as other economic actors. She states that the counterpart to market failure is government failure, and that government inefficiencies and misallocation of resources became apparent in the 1970s and 1980s.

For example, the sheer size of the bureaucracy can inhibit growth. One recent study has shown that a number of countries have extensive surplus labour in the government sector. This can remove labour from other productive activities, thus having negative implications for growth. In addition, political pressures can result in increased government employment through lobbying efforts which can lead to increases in rent-seeking activities, such as employment for friends, etc. The net result can be a drain on a significant proportion of a country's physical and human resources, without a commensurate proportion of directly productive activities.⁴⁴ A large military can also result in similar problems by diverting scarce resources away from more productive activities.

Government monetary policies can also have a profound effect. High real interest rates, coupled with restrictions on the flow of capital to the private sector, have been shown to have a negative impact on private investment. In addition, during a credit squeeze, government attempts to absorb a larger share of domestic financial resources can have similar crowding-out effects. In addition, the flow of foreign capital may not be able to compensate for the shortage of domestic capital if inappropriate exchange rate and interest rate policies are pursued.⁴⁵

Of course, a monetary policy which is loose can be inflationary. Inflation can harm economic growth prospects by distorting prices. Relative price changes normally act to direct resources to their best use. Inflation can distort these price signals. Inflation also moves the economy away from productive activity into speculative rent-seeking activities. Although high rates are a problem, as long as

⁴³Anne O. Krueger, "Government Failures in Development," *Journal of Economic Perspectives*, Vol. 4, No. 3 (Summer 1990), 9-23.

⁴⁴A. Gelb, et al., "Public Sector Employment, Rent Seeking and Economic Growth," *Economic Journal*, Vol. 101, No. 408 (September 1991), 1186-99.

⁴⁵Mario I. Blejer and Moshin S. Khan. "Government Policy and Private Investment in Developing Countries," *IMF Staff Papers*, Vol. 31, No. 2 (June 1984), 379-403.