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# The study of economic development

## CHAPTER OUTLINE

- Development economics as a subject
- Academic interest in development
- The new international economic order
- Globalization and interdependence of the world economy
- The meaning of development and the challenge of development economics
- The perpetuation of underdevelopment

## DEVELOPMENT ECONOMICS AS A SUBJECT

The study of development economics as a separate subject is a relatively recent phenomenon. For the student today it will be difficult to appreciate that as recently as fifty years ago a course in development economics was a rare feature of an undergraduate programme in economics, and that textbooks on economic development were few and far between. Today no respectable department of economics is without a course in economic development; there are scores of texts and thousands of case studies and articles on the subject. And as in medicine, the perceived ills seem to multiply as the diagnosis deepens.

The political and public concern with the poorer nations of the world is of equally recent origin. The majority of the national and international bodies to promote development that exist today, such as national development banks, the World Bank and its affiliates, and agencies of the United Nations, have all been established since the Second World War. Before the war, when most of today's poor countries were still colonies, there was very little preoccupation with the economic and social problems of the developing (dependent) economies that we are concerned with today. Perhaps the facts were not so well known, or perhaps it was that the attention of most people

was focused on depression and underemployment in the developed countries. Whatever the reason for this neglect, the situation today is very different. The development of the Third World (the collective name for the developing countries), meaning above all the eradication of primary poverty, is now regarded as one of the greatest social and economic challenges facing mankind. As the Pearson Report (1969) remarked over 30 years ago 'the widening gap between the developed and the developing countries has become the central problem of our times'.

What accounts for this change in attitude and upsurge of interest in the economics of development and the economies of poor countries? A number of factors can be pinpointed, which interrelate with each other.

- First, in the wake of the great depression and in the aftermath of war there was a renewed academic interest among professional economists in the growth and development process and in the theory and practice of planning.
- Second, the poor countries themselves have become increasingly aware of their own backwardness, which has led to a natural desire for more rapid economic progress.
- Third, the absolute numbers of poor people are considerably greater now than in the past, and greater awareness has struck a humanitarian chord.
- Fourth, there has been a growing recognition by all concerned of the interdependence between countries in the world economy. The political and military ramifications and dangers of a world divided into rich and poor countries are far more serious now than they were in the past; at the same time the old Cold War between the capitalist West and the communist East led the major developed countries to show a growing economic and political interest in poor and ideologically uncommitted nations. The recognition of interdependence has been heightened in recent years by the process of globalization making all countries more vulnerable to shocks and financial crises.

#### ACADEMIC INTEREST IN DEVELOPMENT

Academic interest in the mechanics of growth and development is a *renewed* interest rather than a new preoccupation of economists. The progress and material well-being of people and nations have traditionally been at the centre of economic writing and enquiry. It constituted one of the major areas of interest of the classical economists. Adam Smith, David Ricardo, Thomas Malthus, John Stuart Mill and Karl Marx all dealt at some length (with divergent opinions on many issues) with the causes and consequences of economic advance (see Chapter 4). It is entirely natural that thinkers of the day should comment on the contemporary scene, and there is perhaps an analogy here between the preoccupation of the classical economists at the time of Britain's industrial revolution and the concern of many economists today with the economics of development and world poverty, the nature of which has been brought to the attention of the world so dramatically in recent decades. The list of modern-day economists who have turned their fertile minds to the study of economic development reads like a *Who's Who* of economics. Distinguished economists that immediately come to mind are Pranab Bardhan, Jagdish Bhagwati, Hollis Chenery, Partha Dasgupta, Albert Hirschman, Harry

Johnson, Nicholas Kaldor, Michal Kalecki, Paul Krugman, Simon Kuznets, Harvey Leibenstein, Arthur Lewis, James Mirrlees, Gunnar Myrdal, Raúl Prebisch, Joan Robinson, Paul Rosenstein-Rodan, Walt Rostow, Theodore Schultz, Amartya Sen, Hans Singer, Joseph Stiglitz and Jan Tinbergen (my apologies to those I have left out!).

Development also represents a challenge equivalent to that of depression and mass unemployment in the 1930s, which attracted so many brilliant minds to economics, Keynes among them. But the nature of the challenge is of course very different. In the case of unemployment in the 1930s, there was an orthodox theory with which to grapple; the task was to formulate a theory to fit the facts and to offer policy prescriptions. As it turned out, the solution to the problem was to be costless: expand demand by creating credit and bring idle resources into play. Fancy, an economic problem solved costlessly!

The challenge of development is very different. There is no divorce between theory and the observed facts. The mainsprings of growth and development are well known: increases in the quantity and quality of resources of all kinds. Countries are poor because they lack resources or the willingness and ability to bring them into use. The problems posed by underdevelopment cannot be solved costlessly. It would be reassuring to think, however, that advances in growth theory, coupled with more detailed understanding of the sources of growth and the refinement of techniques for resource allocation, have all increased the possibility of more rapid economic progress than hitherto. Certainly, particular theoretical models and techniques have been used extensively in some countries, presumably in this belief. For example, models for calculating investment requirements to achieve a target rate of growth invariably form an integral part of a development plan; and now the so-called 'new' growth theory (see Chapter 4) provides the rationale and impetus for improving the quality of investment through education, research and development, and infrastructure investment. Good governance must also play a vital role.

The question is often posed as to what lessons, if any, the present developing countries can draw from the first-hand observations of the classical writers, or more directly from the development experience of the present advanced nations. One obvious lesson is that while development can be regarded as a natural phenomenon, it is also a lengthy process, at least left to itself. It is easy to forget that it took Europe the best part of three centuries to progress from a subsistence state to economic maturity. Much of development economics is concerned with the time scale of development, and how to speed up the process of development consistent with freedom and democracy. In the present millennium, when primary poverty in most countries will, it is hoped, have been eradicated, courses in development economics will undoubtedly take a different form. The emphasis will be on intercountry comparisons, rather than on the process of development as such and the growth pains accompanying the transition from a primarily agrarian to an industrial or service economy.

As far as classical theory is concerned, the gloomy prognostication of Ricardo, Malthus and Mill that progress will ultimately end in stagnation would seem to be unfounded. It has certainly been confounded by experience. Population growth and diminishing returns have not been uniformly depressive to the extent that Ricardo and Malthus supposed. Rising productivity and per capita incomes appear quite compatible with the growth of population and the extension of agriculture. Classical development economics

greatly underestimated the beneficial role of technical progress and international trade in the development process. It is these two factors above all which seem to have confounded the pessimism of much of classical theory. With access to superior technology there is hope, and some evidence, that material progress in today's developing countries will be much more rapid than in countries at a similar stage of development one hundred years ago. The pool of technology on which to draw, and the scope for its assimilation, is enormous. Used with discretion, it must be considered as the main means of increasing welfare.

The role of trade, however, is more problematic. A lot will depend on how rapidly the developing countries can alter their industrial structure, and on movements in the terms of trade. Currently the developing countries are probably in an inferior position compared with the present advanced countries at a comparable stage of their economic history. The dynamic gains from trade are present but the static efficiency gains are less and the terms of trade in most commodities are worse. The gains from trade accrue mainly to the rich industrialized countries, notwithstanding the rapid increase that periodically takes place in some commodity prices. The fact that the gains from trade are unequally distributed does not, of course, destroy the potential link between trade and growth, or constitute an argument against trade. Rather, it represents a challenge for altering the structure of trade and the terms on which it takes place.

Then there is the question of planning. Classical economists were generally antithetical to interference with the market mechanism, believing that the free play of market forces would maximize the social good. But fashions change in economics, and after the Second World War there was a much greater acceptance of interference with the market mechanism, and planning in developing countries was seen by many as one of the main means by which development could be accelerated. The experience of planning in many countries, however, has not been favourable and planning has come into disrepute, not least because of the economic disarray of the rigidly planned economies of the old Soviet Union and Eastern Europe. It should never be forgotten, however, that no country in the world ever made such a swift economic advance in such a short space of time as the Soviet Union did after 1918, through a planned allocation of resources that favoured investment at the expense of consumption. The fact that planning may be operated too rigidly, or for too long and go wrong, should not be allowed to obscure the fact that it also has merits, and that unfettered free enterprise can also lead to economic disaster and social deprivation. There can be market failure as well as government failure. What is required in most developing countries is a judicious mix of public and private enterprise, of the use of markets combined with different types of government involvement, for the maximization of social welfare (see Chapter 7).

Planning requires a certain amount of model building, and this too has been inspired by economists. The most common type of model, which forms the basis of much of the model building that developing countries indulge in, is to calculate the investment requirements necessary to achieve a target rate of growth of per capita income – commonly referred to as a Harrod–Domar model (see Chapter 4). Neither the models of Harrod (1939) or Domar (1947) were designed for the purpose to which they are now put in developing countries, but their growth equations have proved to be an indispensable component of macroeconomic planning. We shall consider in Chapter 9 the strengths and weaknesses of using this type of aggregate model in development planning, and the pros and cons of planning in general.

As a result of the apparent failure of development planning and the slow progress made by many developing countries in the 1970s, the status of the discipline of development economics began to be called into question in the 1980s and several obituaries were written (see, for example, Hirschman, 1981; Little, 1982; Lal, 1983). I will concentrate here on the worries expressed by Hirschman, the practitioner who first rang the alarm bells most vigorously. Hirschman argues that development economics was originally born out of a rejection of mono-economics (that is, the universality of neoclassical economics) on the one hand and of neo-Marxism on the other. Neo-Marxism asserted that economic relations between developed and less developed countries could only lead to the development of underdevelopment. The two themes at the forefront of the rejection of mono-economics were (1) the existence of a massive amount of surplus labour in agriculture in developing countries and (2) late industrialization – the latter demanding active state intervention. In terms of policy, the major strategic themes emphasized and pursued by developing countries were the mobilization of underemployed manpower, rapid capital accumulation and industrialization, for all of which planning was thought to be necessary.

Hirschman's first explanation of the alleged demise of development economics is the resurgence of neoclassical orthodoxy and rejection of the view that there is a separate economics applicable to poor countries, as distinct from the developed ones. The defence of mono-economics has been buttressed by the observed success of some ostensibly free-market developing countries, such as South Korea, Hong Kong, Taiwan and Singapore (the so-called 'East Asian miracle' countries), and the failure of planning in others.

Early development economics not only asserted the need for a separate economics applicable to developing countries, but also believed that the integration of developing countries into the world economy would bring material benefits to both rich and poor alike. Hirschman's second explanation of the alleged demise of development economics is that the subject has not only been attacked by the neoclassical school, but also by neo-Marxists who reject the claim of mutual benefit. Thus development economics has been squeezed, as if in a vice, from both ends of the politico-economic spectrum.

What can be said in response? It is not difficult to defend the traditional preoccupations of development theory and development policy. Amartya Sen (1983) and Syed Naqvi (1996) show that the focus on **mobilizing surplus labour, capital accumulation and industrialization** has not been misplaced. It can be seen from the international evidence that many high-growth countries (and this is particularly true of South-East Asian countries today) have drawn extensively on surplus labour from the rural sector; that investment and growth are highly correlated across countries; and that the best growth performers are those countries where the share of industrial output in gross domestic product (GDP) is rising most rapidly. Those defending the rejection of mono-economics have not retreated into their shells, and very few economists would disagree that there is mutual benefit to be had from country interaction. It is not conceivable that the majority of developing countries would be absolutely better off if they were isolated and autarchic, although this is not to say that some 'delinking' may not be desirable and that the gains from globalization and interdependence could not be more equitably distributed.

But is there a separate development economics? Most observers would still argue that poor countries differ from the rich in such a way that different concepts, models

and theories are required to understand their functioning in many respects. While it might be argued that the basic microeconomic assumptions about how people behave are similar for all countries, developing countries still differ *structurally* from rich ones and therefore require different models. The differences between the two sets of countries are large, particularly in relation to resource allocation and matters relating to long-term growth. It is not accidental that social cost-benefit analysis has been largely developed and refined within the context of developing countries, nor that developing countries have been the breeding ground for theories of tendencies towards disequilibrium in economic and social systems – models of virtuous and vicious circles and centre-periphery models of growth and development. But as Arthur Lewis, one of the fathers of development economics, once said in his presidential lecture to the American Economic Association, the central task of development economics is to provide a general framework for an understanding of the pace and rhythm of growth and development. As he put it: ‘the economists’ dream would be to have a single theory of growth that took an economy from the lowest level . . . past the dividing line . . . up to the level of Western Europe and beyond . . . or to have at least one good theory for the developing economy . . . to the dividing line’ (Lewis, 1984). That is what development economics is all about. Development economics is the only branch of economics that attempts to offer an adequate explanation of the nature of the development process (Naqvi, 1996).

But even if the need for a separate development economics could not be established, would this jeopardize the status of the subject? It might be argued that in the interests of scientific respectability there is a strong case for thinking of economics as a unified body of theory and doctrine, and not a subject of compartments. But what leads to compartmentalization is the wide diversity of subject areas, which then leads to the descriptive labels of monetary economics, labour economics, regional economics and so on, but all these subdisciplines employ a large measure of theory that is common to economics as a whole.

What distinguishes the subdiscipline is first and foremost the area of application and only secondarily the distinctive theory. A favourite definition of economics is that ‘economics is what economists do’. By analogy, ‘development economics is what development economists do’. The development literature indicates that they do a number of things that other economists do not do, and in the process they both invent new models, and adapt and modify existing theory in the light of circumstances. Any contribution that a subdiscipline makes by way of theoretical development enriches economics as a whole, and may well have application elsewhere. New models, concepts and ideas invented by development economists include the following:

- The concept of the low-level equilibrium trap
- The theory of the ‘big push’
- Dynamic externalities
- Models of dualism
- The theory of circular and cumulative causation
- The concept of dependency
- Growth pole analysis
- Models of population and growth
- Models of rural–urban migration

- Refinements to social cost–benefit analysis
- The notion of immiserizing growth
- Models of structural inflation
- The concept of dual-gap analysis
- The theory of missing markets
- The study of rent-seeking; and so on.

None of these innovations has been borrowed from other branches of economics, but other branches of economics have borrowed liberally from the expanding tool kit forged by development economists. International economics is no longer taught within the straitjacket of equilibrium economics. Labour economics has taken on board the concepts of dualism and dual labour markets, while structural inflation and dual-gap analysis are part of the language of macroeconomics. As Bardhan (1993) concludes:

While the problems of the world’s poor remain as overwhelming as ever, studying them has generated enough analytical ideas and thrown up enough challenges to the dominant paradigm to make all of us in the profession somewhat wiser, and at least somewhat more conscious of the possibilities and limitations of our existing methods of analysis.

Finally, how should one respond to the charge that development economics has not produced the results expected of it? As Hirschman (1981) puts it, the developing countries were ‘expected to perform like wind-up toys and “lumber through” the various stages of development single-mindedly . . . these countries were perceived to have only *interests* and no *passions*’. If the expectations have not materialized, this probably has more to do with the expectations being unrealistic than deficiencies in the theory and practice of development economics. This in turn may have something to do with economists in general losing their historical sense and perspective. The process of development is a long, protracted process. It took over two hundred years for the present developed countries to progress from Rostow’s traditional stage of economic development to economic maturity and high mass consumption. Arthur Lewis (1984) bemoans the loss of historical perspective, which he attributes to the poor training of economists: ‘If our subject is lowering its sights, this may be because the demise of economic history in economics departments has brought us a generation of economists with no historical background. This is in marked contrast with the development economists of the 1950s, practically all of whom had some historical training, and guided by Gerschenkron and Rostow, looked to history for enlightenment on the processes of development.’ Students beware: Learn your history!

Where do we stand today? At the present time there is a resurgence of academic interest in the growth and development process, inspired by the ‘new’ endogenous growth theory and the increased availability of large data sets that facilitate interesting and rigorous econometric work on the major determinants of intercountry growth performance. Paul Krugman (1992) has described the 1950s and 1960s as the years of ‘high development theory’, when many important models of development were formulated but were lost sight of because they were not formulated rigorously enough. Now the ideas are being brought back into play by more skilled theoreticians. The central core of ideas that emerged in the 1950s and 1960s, which were largely swept away during the neoclassical counter-revolution but which Krugman believes still remain valid, were **external economies**, **increasing returns**, **complementarity between sectors** and **linkages**. It is these ideas

that have been recaptured by the 'new' endogenous growth theory (and which remained alive outside the mainstream in the works of such economists as Nicholas Kaldor and Kenneth Arrow – see Chapter 4).

New growth theory provides an answer to the question of why per capita income differences in the world economy seem to be as persistent as ever when conventional neoclassical growth theory predicts convergence. The answer is that there are many externalities that prevent the marginal product of capital from falling as countries get richer, so that the level of investment matters for growth, and growth is endogenous in this sense – not simply determined by an exogenously given rate of technical progress, common to all countries. Indeed technical progress is also largely endogenous, determined by research and development (R&D) and education. This theory tells us what sustains growth, but it does not address the question of what it is that gets growth started. To answer this we need to go to the roots of economic development, which initially lie in the performance of the rural economy and agriculture (see Chapter 5).

## THE NEW INTERNATIONAL ECONOMIC ORDER

Another major factor accounting for the upsurge of interest in the growth and development process has been the poor nations' own increased awareness of their inferior economic and political status in the world, and their desire for material improvement and greater political recognition through economic strength. This was precipitated by decolonization and increased contact with the developed nations, and has been strengthened from within by rising expectations as development has proceeded. Development is wanted to provide people with the basic necessities of life, for their own sake, and to provide a degree of self-esteem and freedom for people, which is precluded by poverty. Wealth and material possessions may not provide greater happiness but they widen the choice of individuals, which is an important aspect of freedom and welfare. The developing countries have also called for a fairer deal from the functioning of the world economy, which they view, with some justification, as biased in favour of countries that are already rich.

The official call for a **new international economic order** was made during the Sixth Special Session of the United Nations General Assembly in 1974. The United Nations pledged itself

to work urgently for the establishment of a new international economic order based on equity, sovereign equality, common interest and cooperation among all States, irrespective of their economic and social systems, which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and the developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations.

The programme of action called for such things as:

- Improved terms of trade for the exports of poor countries
- Greater access to the markets of developed countries for manufactured goods
- Greater financial assistance and the alleviation of past debt
- Reform of the International Monetary Fund and a greater say in decision-making on international bodies concerned with trade and development issues

- An international food programme
- Greater technical cooperation.

The call for a new international economic order has been reiterated several times by various UN agencies. In 1975 the United Nations Industrial Development Organization (UNIDO) produced the **Lima Declaration**, which set a target for the developing countries to secure a 25 per cent share of world manufacturing production by the year 2000 compared with the share then of 10 per cent. The 2005 share is only 15 per cent and the target has not been met. On the monetary front, in 1980 the **Arusha Declaration** demanded a UN Conference on International Money and Finance to create a new international monetary order 'capable of achieving monetary stability, restoring acceptable levels of employment and sustainable growth' and 'supportive of a process of global development'.

In 1995 a UN World Development Summit was held in Copenhagen, focusing on social development and employment issues. The **Copenhagen Declaration** made several commitments:

- Full employment, equality between men and women, and universal access to education and health care should be basic priorities.
- Overall development aid should be increased for spending in areas of social policy.
- Developed countries should allocate 20 per cent of their aid to basic social projects and in return developing countries should spend at least 20 per cent of their budgets on social needs.
- The IMF and the World Bank should pay more attention to social factors when designing programmes.

The United Nations Conference on Trade and Development (UNCTAD) regularly calls for new policy initiatives in the four major areas of debt relief, international aid, commodity policy and trade promotion for developing countries.

## MILLENNIUM DEVELOPMENT GOALS

The latest commitment endorsed by the World Bank and the United Nations (UN) is for the percentage of the world's population living in absolute poverty to be halved by the year 2015, compared to the level in 1990. This means a reduction from 30 per cent to 15 per cent. In 2005 the level is just over 20 per cent, although it is much higher than this in particular countries. In addition several other development goals and targets have been set, outlined fully in Case example 1.1. They relate to:

- Enrolling all children in primary school by 2015
- Making progress towards gender equality, particularly in education
- Reducing child mortality
- Reducing maternal mortality
- Providing universal access to reproductive health services
- Implementing national strategies for sustainable development and to reverse the loss of environmental resources.

Each of the goals addresses an aspect of poverty, and all are mutually reinforcing. For example, higher school enrolment, especially for girls, reduces poverty and mortality. Better basic health care will increase school enrolment and reduce poverty. Many poor people earn their living from the environment, so a better environment will help poor people.

To achieve the major goal of halving the poverty rate by the year 2015 will require a sustained growth of per capita income in the countries affected, at rates much higher than experienced in the recent past, particularly in Africa. On average, the poverty rate tends to fall by about one per cent for every one per cent increase in per capita income, so a 50 per cent increase in per capita income would be required to reduce the poverty rate from, say, 40 per cent to 20 per cent. This is the challenge facing Africa over the next ten years if the Millennium targets are to be met (see Chapter 2 p. 41 for more detailed calculations).

### Case example 1.1

## Millennium Development Goals and Targets

### **Goal 1: Eradicate extreme poverty and hunger**

*Target 1:* Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day.

*Target 2:* Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

### **Goal 2: Achieve universal primary education**

*Target 3:* Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

### **Goal 3: Promote gender equality and empower women**

*Target 4:* Eliminate gender disparity in primary and secondary education, preferably by 2005 and in all levels of education no later than 2015.

### **Goal 4: Reduce child mortality**

*Target 5:* Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

### **Goal 5: Improve maternal health**

*Target 6:* Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

### **Goal 6: Combat HIV/AIDS, malaria and other diseases**

*Target 7:* Have halted by 2015 and begun to reverse the spread of HIV/AIDS.

*Target 8:* Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases.

### **Goal 7: Ensure environmental sustainability**

*Target 9:* Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources.

## Case example 1.1 cont'd

*Target 10:* Halve by 2015 the proportion of people without sustainable access to safe drinking water.

*Target 11:* Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers.

**Goal 8: Develop a global partnership for development**

*Target 12:* Develop further an open, rule-based, predictable, non-discriminatory trading and financial system (includes a commitment to good governance, development, and poverty reduction – both nationally and internationally).

*Target 13:* Address the special needs of the least developed countries (includes tariff- and quota-free access for exports, enhanced programme of debt relief for and cancellation of official bilateral debt, and more generous official development assistance for countries committed to poverty reduction).

*Target 14:* Address the special needs of landlocked countries and small island developing states (through the Programme of Action for the Sustainable Development of Small Island Developing States and 22nd General Assembly provisions).

*Target 15:* Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term.

*Target 16:* In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.

*Target 17:* In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries.

*Target 18:* In cooperation with the private sector, make available the benefits of new technologies, especially information and communications technologies.

*Source:* UNDP, *Human Development Report 2002* (New York: Oxford University Press, 2002).

## GLOBALIZATION AND INTERDEPENDENCE OF THE WORLD ECONOMY

A third major factor responsible for the growing interest and concern with Third World development is the increased **globalization** of the world economy leading to a greater interdependence between countries of the world. There have been three major eras of globalization in the last 150 years. The first was from 1870 to the First World War (1914) which witnessed large scale capital flows and labour migration from Europe to the American continent and the colonies. The second started after the Second World War with the freeing of trade. The third phase started in the 1980s based on technological advances in communications and transport. Fischer (2003) has given a useful, succinct definition of globalization:

the ongoing process of greater economic interdependence among countries reflected in the increasing amount of cross-border trade in goods and services, the increasing volume of international financial flows and increasing flows of labour.

As far as the interdependence between developed and developing countries is concerned, developing countries depend on developed countries for resource flows and technology, while developed countries depend heavily on developing countries for raw materials, food and oil, and as markets for industrial goods. The term globalization refers to all those forces operating in the world economy that increase interdependence and at the same time make countries more and more dependent on forces outside of their control, as time, space and borders diminish in importance. Foremost among these forces are:

- The widening and freeing of trade. Over 20 per cent of the world's output of goods and services is now traded.
- The growth of global capital markets and the greater flow of short-term speculative capital: over 2 trillion dollars are exchanged on the world's currency markets every day.
- More foreign direct investment (FDI) by giant multinational corporations with more power and assets than many national governments.
- The growth of global value chains with firms sourcing inputs from the cheapest international markets.
- The greater movement of people than ever before, breaking down cultural barriers – but also leading to the spread of disease (e.g. AIDS) and international crime in drugs, prostitution and arms.
- The spread of information technology (IT) which can exacerbate contagion in financial markets (e.g. the 1997 financial crisis in South-East Asia).
- New institutions, such as the World Trade Organization (WTO), with authority over national governments, and new multilateral agreements on trade, services, intellectual property, etc., which reduce national autonomy.

All these aspects of globalization and interdependence make countries more vulnerable to shocks such as: world recessions and downturns in world trade; financial crises, such as the Asian crisis of 1997 which became contagious and spread like a disease affecting not only the region of South-East Asia, but other parts of the world too; and decisions by big multinational companies to withdraw investment or relocate. In recent years there have been major protests at meetings of the WTO and the World Economic Forum in Davos (Switzerland) by groups concerned with the damage done by globalization, particularly to the poorer countries in the world economy which tend to be most exposed to, and suffer most from, the forces of competition and global capital movements. Competitive markets may be the best guarantee of efficiency, but not necessarily of equity. As the *Human Development Report* of the United Nations Development Programme (UNDP) (1999) put it:

The challenge of globalisation in the new century is not to stop the expansion of global markets. The challenge is to find the rules and institutions for stronger governance – local, national, regional and global – to preserve the advantages of global markets and competition, but also to provide enough space for human, community and environmental resources to ensure that globalisation works for people – not just for profits.

So far, more progress has been made in promoting the institutions of globalization than in protecting people against the consequences of globalization. The UNDP calls for globalization tempered by:

- **Ethics** – less violation of human rights
- **Equity** – less disparity within and between nations
- **Inclusion** – less marginalization of people and countries
- **Human security** – less instability of countries and less vulnerability of people
- **Sustainability** – less environmental destruction
- **Development** – less poverty and deprivation.

When the actions of any one country, or group of countries, result in consequences for others (good or bad), the effects become a type of **public good** or **externality**. The task of the international community in these circumstances is to maximize the spread of public goods which confer positive externalities (e.g. technology, information, health care) and to minimize the spread of public 'bads' (e.g. disease, pollution, financial contagion). It is in the self-interest of the international community to particularly assist developing countries not only because they are poor but also to enable them to make their contribution to the provision of essential global public goods (and to minimize the production of public 'bads', e.g. AIDS in Africa).

Globalization and interdependence particularly means that the malfunctioning of one set of economies impairs the functioning of others. This was never more evident than in the world economy in the 1980s, when owing to the rising price of energy and the debt crisis, there was mounting economic chaos. The 1980 Brandt Report, entitled *North–South: A Programme for Survival* (1980), and its sequel *Common Crisis: North–South Co-operation for World Recovery* (Brandt Commission, 1983), stressed the mutual benefit to all countries of a sustained programme of development in the Third World, and documented the prevailing adverse trends in the world economy, which pointed to a sombre future if not tackled cooperatively:

- Growing poverty and hunger in the Third World
- Rising unemployment with inflation
- International monetary disorder
- Chronic balance of payments deficits and mounting debts in most Third World countries
- Protectionism, and tensions between countries competing for energy, food and raw materials.

Development economics addresses itself to many of the issues contributing to disarray in the world economy.

There is not only a moral case for greater efforts to raise living standards in Third World countries, but a purely practical case that it is in the interests of the developed countries themselves. The ability of poor countries to sustain their growth and development means a greater demand for the goods and services of developed countries, which generates output and employment directly and also helps to maintain the balance-of-payments stability of these countries, which is so crucial if there is to be a reciprocal demand for the goods of developing countries. Any constraint on demand in the system arising from, say, poor agricultural performance in poor countries, or a balance-of-payments constraint on demand in developed countries, will impair the functioning of the whole system and reduce the rate of progress below potential. Herein lies the importance of the transfer of resources to poor countries to maintain their momentum

of development (global Keynesianism), and of international monetary reform to smooth the burden of balance-of-payments adjustment and to shift more of the burden of adjustment from the deficit to the surplus countries.

The Brandt Report called for a short-term emergency programme as a prelude to longer-term action, consisting of four major elements:

- A large-scale transfer of resources to developing countries
- An international energy strategy to minimize the dislocation caused by sudden and rapid increases in the price of oil
- A global food programme
- A start on some major reforms in the international monetary system.

To date, very little has been done.

In the longer term the Brandt Report called for:

- A twenty-year programme to meet the basic needs of poor countries, involving additional resource transfers of \$4 billion a year.
- A major effort to improve agricultural productivity to end mass hunger and malnutrition.
- Commodity schemes to stabilize the terms of trade for primary commodities.
- Easier access to world markets for the exports of developing countries.
- Programmes for energy conservation.
- The development of more appropriate technologies for poor countries.
- An international progressive income tax, and levies on trade and arms production, to be used by a new World Development Fund (to fund development programmes rather than projects).
- A link between the creation of new international money and aid to developing countries.
- Policies to recycle balance-of-payments surpluses (as accumulated by the Arab oil exporting countries since 1973, for example) to deficit countries to remove balance-of-payments constraints on demand and remove the risk of a slide into international protectionism.

We could add to this list new forms of global governance to cope with the consequences of globalization, and which at the same time also represent the interests of those countries that suffer most from the effects of globalization: the poor and marginalized.

We shall discuss many of these issues in the course of this book. Such a programme of action would be of mutual benefit to all parties, rich and poor. It would create investment confidence, which is the crucial ingredient maintaining the dynamics of any economic system; it would stimulate trade and investment, and help the prospects of sustained growth in the world economy.

It would be wrong to give the impression, however, that the developed countries' concern with world poverty is motivated exclusively by the selfish realization that their own survival depends on economic and political harmony, which cannot thrive in a world perpetually divided into rich and poor. There has also been an affirmation by many developed countries of a moral obligation towards poorer nations. Not all aid and development assistance is politically inspired. Particularly over the last three decades, the developed countries have shown a genuine humanitarian concern over the plight of

Third World countries, which has resulted in the establishment and support of several institutions to assist developing countries, and which led the period 1960–70 to be named the ‘First Development Decade’.

We are now in the Fifth Development Decade, and the pledge to assist developing countries out of humanitarian concern has been reaffirmed. The goal of a greater degree of income equality between the citizens of a nation seems to be gaining support, albeit slowly, as an objective among nations. Moreover the propagation of this ideal is not confined to the supranational institutions that have been especially established to further it. Recent years have witnessed the spontaneous creation of several national pressure groups in different parts of the world, whose platform is the abolition of world poverty; and the Church, which remained silent and inactive for so long, periodically makes its voice heard. Aid from voluntary agencies to developing countries now amounts to over \$5 billion annually. But whatever the motive for concern, the reality of world poverty and underdevelopment cannot be ignored. Furthermore, primary poverty in developing countries is likely to persist for many years to come. The economist has a special responsibility to contribute to an understanding of the economic difficulties that poor countries face and to point to possible solutions. This is a textbook devoted to that end.

We start by considering the meaning of development and the perpetuation of underdevelopment. Then in Chapters 2 and 3 we consider the measurement of poverty, the magnitude of the development gap in the world economy, and the major characteristics of underdevelopment, particularly the employment situation, the income distribution, the level of nutrition and other basic needs such as education and health care.

## THE MEANING OF DEVELOPMENT AND THE CHALLENGE OF DEVELOPMENT ECONOMICS

Development implies change, and this is one sense in which the term development is used, that is, to describe the process of economic and social transformation within countries. This process often follows a well-ordered sequence and exhibits common characteristics across countries, which we shall discuss later in the chapter. But if development becomes an objective of policy, the important question arises of: development for what? Not so long ago the concept of development, defined in the sense of an objective or a desired state of affairs, was conceived of almost exclusively in terms of growth targets, with very little regard to the beneficiaries of growth or the composition of output. Societies are not indifferent, however, to the distributional consequences of economic policy, to the type of output that is produced, or to the economic environment in which it is produced. A concept of development is required that embraces the major economic and social objectives and values that societies strive for. This is not easy. One attempt is by Goulet (1971), who distinguishes three basic components or core values in this wider meaning of development, which he calls **life-sustenance**, **self-esteem** and **freedom**.

**Life-sustenance** is concerned with the provision of basic needs, which we shall discuss in Chapter 3. The basic needs approach to development was initiated by the World Bank in the 1970s. No country may be regarded as fully developed if it cannot provide all its people with such basic needs as housing, clothing, food and minimal education. A major

objective of development must be to raise people out of primary poverty and to provide basic needs simultaneously.

**Self-esteem** is concerned with the feeling of self-respect and independence. No country can be regarded as fully developed if it is exploited by others and does not have the power and influence to conduct relations on equal terms. Developing countries seek development for self-esteem; to eradicate the feeling of dominance and dependence that is associated with inferior economic status.

**Freedom** refers to freedom from the three evils of 'want, ignorance and squalor' so that people are more able to determine their own destiny. No person is free if they cannot choose; if they are imprisoned by living on the margin of subsistence with no education and no skills. The advantage of material development is that it expands the range of human choice open to individuals and societies at large.

All three of these core components are interrelated. Lack of self-esteem and freedom result from low levels of life sustenance, and both lack of self-esteem and economic imprisonment become links in a circular, self-perpetuating chain of poverty by producing a sense of fatalism and acceptance of the established order – the 'accommodation to poverty' as Galbraith (1980) once called it.

Goulet's three core components of development are also related to Amartya Sen's vision of development (Sen, 1983, 1984, 1999), defined in terms of the expansion of **entitlements** and **capabilities**, the former giving life sustenance and self-esteem; the latter giving **freedom**. Sen defines entitlements as 'the set of alternative commodity bundles that a person can command in a society using the totality of rights and obligations that he or she faces', and entitlements generate the capability to do certain things. Economic development should be thought of in terms of the expansion of entitlements and capabilities, which are not well captured by aggregate measures of output growth. For most people, entitlements depend on their ability to sell their labour and on the price of commodities. It is not only the market mechanism that determines entitlements, however, but also such factors as power relations in society, the spatial distribution of resources in society, such as schools and health care, and what individuals can extract from the state.

In the final analysis, it is **freedom** that Sen views as the primary objective of development, as well as the principal means of achieving development. Development consists of the removal of various types of 'unfreedoms' that leave people with little choice and opportunity. Major categories of 'unfreedom' include famine and undernourishment, poor health and lack of basic needs; lack of political liberty and basic civil rights, and economic insecurity. Development should be regarded as a process of expanding the real freedoms that people enjoy. The growth of per capita income is only a means to that end. The ideas and views of Amartya Sen, who won the Nobel Prize for Economics in 1998 for his work on the interface between welfare and development economics, have been enormously influential within the international community and can be most recently seen in the World Bank's *World Development Report 2000/2001* which is devoted to the topic of how to expand the entitlements, capabilities and freedom of poor people (see Chapter 2).

The focus and stress on expanding entitlements and capabilities for *all* people is a natural extension of the earlier switch in development thinking away from growth maximization to concern with the structure of production and consumption and the distribution of income. Sen's dissent is that income is often a very inadequate measure

of entitlement, which he tries to illustrate with reference to the incidence of famines across the world. He finds that most famines have been associated with a lack of entitlements, not with a lack of food.

Using Goulet's and Sen's concept of development, therefore, and in answer to the question 'development for what?', we can say that development has occurred when there has been an improvement in basic needs, when economic progress has contributed to a greater sense of self-esteem for the country and individuals within it, and when material advancement has expanded people's entitlements, capabilities and freedoms. The fact that many of these ingredients of development are not measurable does not detract from their importance: the condition of being developed is as much a state of mind as a physical condition measurable by economic indices alone.

The challenge of development economics lies in the formulation of economic theory, and in the application of policy, in order to understand better and to meet these core components of development. Clearly the range of issues that development economics is concerned with is quite distinctive and because of this the subject has developed its own *modus vivendi* (way of doing things), although drawing liberally on economic theory, as do other branches of economics.

If it is to be useful, however, a great deal of conventional economic theory must be adapted to suit the conditions prevailing in developing countries, and many of the assumptions that underlie conventional economic models have to be abandoned if they are to yield fruitful insights into the development process. Static equilibrium theory, for example, is ill-suited to the analysis of growth and change and of growing inequalities in the distribution of income between individuals and countries. It is probably also true, as Todaro and Smith (2003) strongly argue, that economics needs to be viewed in the much broader perspective of the overall social system of a country (which includes values, beliefs, attitudes towards effort and risk taking, religion and the class system) if development mistakes are to be avoided that stem from implementing policy based on economic theory alone.

## THE PERPETUATION OF UNDERDEVELOPMENT

The study of economic development helps us to understand the nature and causes of poverty in low-income countries, and the transformation of societies from primarily rural to primarily industrial, with the vast bulk of resources utilized in industrial activities and in service activities that serve the industrial sector. But why have some countries hardly participated in this process or have been left behind? The first industrial revolution gave the present developed countries an initial advantage, which they then sustained through the existence of various cumulative forces against those left behind. In the last fifty years there has been a second industrial revolution, which has propelled another bloc of countries (the so-called 'newly industrialized countries' of South-East Asia and Latin America) into a virtually industrialized state, and many others into a semi-industrialized state. But many countries are still left behind in a semi-feudal state, including the very poorest, which have now become the prime focus of concern of the World Bank and other development agencies.

There are many theories of the perpetuation of underdevelopment but none seems to have universal validity. The state of agriculture is of foremost importance. It was, first

of all, settled agriculture that laid the basis for the great civilizations of the past, and it was the increase in agricultural productivity in England in the eighteenth century that laid the basis for, and sustained, the first industrial revolution. If there is one overriding factor that explains why some countries developed before others, and why some countries are still backward without a significant industrial sector, it lies in the condition of agriculture, which in the early stages of development is the sector that must provide the purchasing power over industrial goods.

The condition of agriculture depends on many factors, institutional as well as economic, and physical conditions are also of key importance. Climate particularly affects the conditions of production. Heat debilitates individuals. Extremes of heat and humidity also reduce the quality of the soil and contribute to the low productivity of certain crops. It cannot be coincidence that almost all developing countries are situated in tropical or subtropical climatic regions and that development 'took off' in the temperate zones.

The condition of agriculture has not been helped by what Lipton (1977) called **urban bias**, which in many countries has starved agriculture of resources. This has happened because ruling elites generally originate from, or identify with, the non-rural environment, and because policy-makers have been led astray both by empirical evidence that shows a high correlation between levels of development and industrialization, and by early development models that stressed investment in industry.

Many other internal conditions have acted as barriers to progress in poor countries, barriers that interacted in a vicious circle. In some countries population size presents a problem, combined with low levels of human capital formation. The latter in turn perpetuates poverty, which is associated with high birth rates and large family size. This is a form of 'accommodation to poverty' (Galbraith, 1980), which then perpetuates low living standards in a circular process. Other countries may lack the psychological conditions required for modernization, built on individualism and the competitive spirit, coupled with a strong work ethic, rationalism and scientific thought, which characterized the industrial revolutions of eighteenth- and nineteenth-century Europe, and which played a large part in the emergence of the newly industrialized South-East Asian countries in the latter half of the twentieth century.

External relations between countries also play a part in the poverty perpetuation process, and this has given rise to **structuralist** and **dependency** theories of underdevelopment. It seems to be the general lesson of history that once one set of countries gains an economic advantage, the advantage will be sustained through a process of what Myrdal (1957) has called 'circular and cumulative causation', working through the media of factor mobility and trade. (For a full discussion, see Chapter 7.) Favoured regions denude the backward regions of capital and skilled labour, and they trade in commodities whose characteristics guarantee that the gains from trade accrue to them. **Colonialism** was an extreme form of dependency, and many of the countries so exploited are still poor today. On the other hand a number of countries that were never colonized, such as Ethiopia and Thailand, are equally backward.

Dependence can take more subtle forms, however, based on the international division of labour, for example, which leads to unequal exchange relations between rich and poor, with the poor dependent on the rich for capital and technology to equip their industrial sectors. The current indebtedness of the less developed countries, the 'increasing price' that poor countries have to pay for development inputs relative to the price they

receive for their exports, and the growing number of poor people are manifestations of this dependency. There are exceptions to the thesis of 'circular and cumulative causation', but in most cases it requires a strong exogenous shock to break out of a vicious circle of poverty and dependency.

We shall take up some of these issues in Part III of this book, but in Chapter 2 we turn our attention to the magnitude of poverty in developing countries and the world distribution of income.

## DISCUSSION QUESTIONS

- 1 What constitutes the study of development economics?
- 2 Do you think there is a case for a separate subject of development economics, and what are the arguments against it?
- 3 What accounts for the political and academic interest in Third World development?
- 4 Why was the status of the discipline of development economics called into question in the 1970s?
- 5 How would you define the process of economic development?
- 6 What do the developing countries want from a 'new international economic order'?
- 7 Do you think that the Millennium Development Goals are achievable?
- 8 What forces perpetuate underdevelopment?
- 9 What lessons, if any, can poor countries learn from the development experience of today's industrialized countries?
- 10 What is meant by 'globalization' and the mutual dependence between rich and poor countries?
- 11 What do you see as the major challenges confronting development economics and the developing countries?

## WEBSITES

The study of development economics requires a good deal of reading and familiarity with case-study material, as well as access to statistical sources. Below is a list of general Internet sites that can be accessed with links to topics, countries, regions and international organizations. Other sites on specific topics will be given at the end of other chapters.

### **Institutes of Development Studies**

Canadian International Development Agency (Virtual Library on International Development) <http://w3.acdi-cida.gc.ca/virtual.nsf>

Institute of Development Studies, University of Sussex (British Library for Development Studies) [www.ids.ac.uk/blds/index.html](http://www.ids.ac.uk/blds/index.html)

School of Development Studies, University of East Anglia [www.uea.ac.uk/dev/](http://www.uea.ac.uk/dev/)

**International organizations**

World Bank [www.worldbank.org](http://www.worldbank.org)  
International Monetary Fund [www.imf.org](http://www.imf.org)  
United Nations Conference on Trade and Development (UNCTAD) [www.unctad.org](http://www.unctad.org)  
United Nations Development Programme (UNDP) [www.undp.org](http://www.undp.org)  
Food and Agricultural Organization (FAO) [www.fao.org](http://www.fao.org)  
World Trade Organization (WTO) [www.wto.org](http://www.wto.org)  
World Health Organization (WHO) [www.who.int](http://www.who.int)  
United Nations Industrial Development Organization (UNIDO) [www.unido.org](http://www.unido.org)  
International Labour Organization (ILO) [www.ilo.org](http://www.ilo.org)  
African Development Bank <http://afdb.org>  
Asian Development Bank [www.adb.org](http://www.adb.org)  
Inter-American Development Bank [www.iadb.org](http://www.iadb.org)  
World Development Movement [www.wdm.org.uk](http://www.wdm.org.uk)  
Centre for Global Development (Washington) [www.cgdev.org](http://www.cgdev.org)  
Non-Governmental Organizations Global Network [www.ngo.org](http://www.ngo.org)  
Heritage Foundation [www.heritage.org](http://www.heritage.org)

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Penn World Tables (accessed through the National Bureau of Economic Research) [www.nber.org/pub/pwt56.html](http://www.nber.org/pub/pwt56.html)  
Economic Growth Resources (Jon Temple, Bristol University) [www.bris.ac.uk/Depts/Economics/Growth](http://www.bris.ac.uk/Depts/Economics/Growth)  
World Bank <http://econ.worldbank.org/prr/globalisation>  
IMF/World Bank Library Network <http://jotis>

**Globalization**

Department for International Development, UK [www.globalisation.gov.uk](http://www.globalisation.gov.uk)  
Centre for Research on Globalization <http://www.globalresearch.ca>  
The Globalization Website <http://www.emory.edu/soc/globalization/>  
Institute for International Economics <http://www.iie.com/research/globalization.htm>  
New Economics Foundation [www.neweconomics.org/gen](http://www.neweconomics.org/gen)

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