Theories and Practices of Development

Second edition

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Routledge Perspectives on Development

2 Modernization, Keynesianism and neoliberalism

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This chapter deals with development theories that focus on the central role of the market in promoting economic progress. The role of other development actors, most notably the state, should not be ignored, but in most cases the state is viewed as an enabler for more effective market operations.

Classical theories

While the bulk of this book focuses on post-1945 development theories and policies, it is important to recognize that these ideas did not appear in an intellectual vacuum, but rather were rooted in the tradition of economic, political and sociological theorizing which developed in Europe from the eighteenth century onwards (Martinussen 1997: Chapter 2).

One of the key theorists to influence later ideas about economic development was Adam Smith. His book, *An Inquiry into the Nature and Causes of the Wealth of Nations* was published in 1776 and was a response to the mercantile (trade) focus of economic policy at that time in Western Europe. In the eighteenth century, it was trade which was the major force for economic growth; merchants, and particularly the large trading companies (such as the East India Company), had great power in relation to national governments. In order to safeguard their interests, merchants supported protectionist measures which allowed them to carry out their activities without what they saw as unnecessary competition. Protectionism included high import tariffs for goods produced outside a country. This made it cheaper for customers to buy domestically-produced goods.

Adam Smith viewed this form of regulation as detrimental to the economic growth of the country and greater wealth for all citizens, rather than just the merchant classes. He argued for greater attention to be paid to production, rather than trade, in economic development. In addition, he claimed that divisions of labour would help improve productivity and therefore economic growth and wealth creation. Division of labour describes the breaking up of the production process (for example making cloth) into a number of stages; rather than one person completing all stages, different people concentrate on one aspect of the process. They become greatly skilled at this and so more items can be produced in the same time.

The operation of the proposed system, he argued, would be regulated by the 'invisible hand of the market' rather than by the state (see Chapter 1 for a discussion of these actors). Smith believed that individuals would act in self-interest; thus if a product was too expensive then nobody would buy it and the seller would either reduce the prices or change to selling something else. Similarly, if wages were too low, then workers would move to other jobs. Despite writing before the turmoil and 'economic development' of the Industrial Revolution, Smith's work is still very influential today because of his theorizing about the role of the market in economic development. The market-centred approach to economic development has also been termed laissez-faire economics.

Another highly influential classical economist was David Ricardo, who lived in the late eighteenth to early nineteenth centuries. He was a great advocate of free trade and developed the theory of 'comparative advantage'. According to this theory, countries should concentrate on producing and then selling the goods that they had an advantage in producing because of their assets, such as land, mineral resource, labour, technical or scientific expertise. This meant a global division of labour. Ricardo argued that it made more sense for countries to specialize in this way, rather than trying to produce everything, because through specializing, production would be more efficient, there would be greater capacity for growth and scarce resources could be used more effectively (see Figure 2.1).

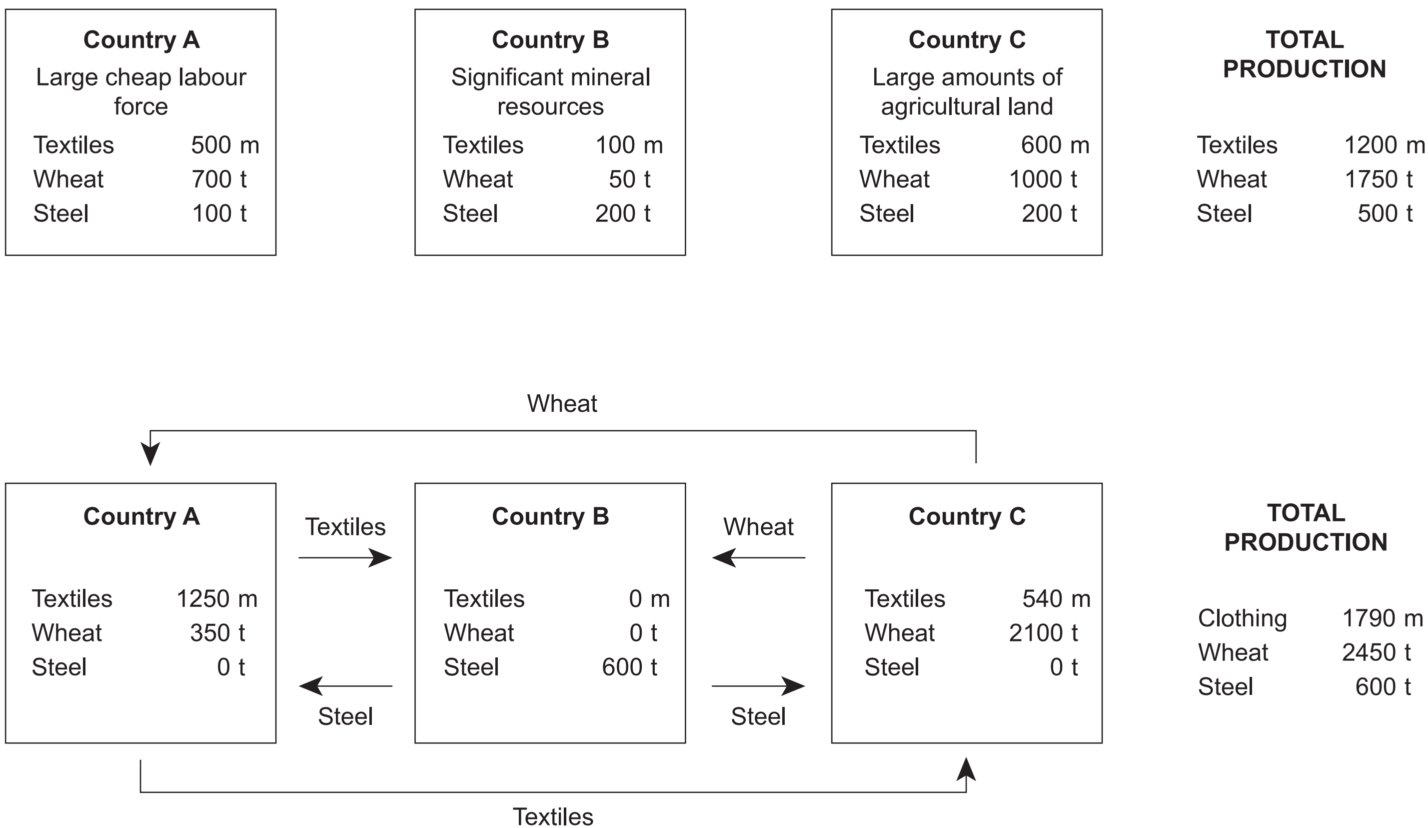

Figure 2.1 Comparative advantage.

Economic growth theory

Classical economists' belief in the market as a mechanism for maximizing efficient resource use and human well-being, was challenged in the early twentieth century by significant economic events, in particular the 1929 Wall Street Crash and the Great Depression of the 1930s in the USA. From this extreme failure of the free market to reach an equilibrium, economists began to develop new understandings of national economies. Foremost among these was the British economist John Maynard Keynes, who in 1936 published *The General Theory of Employment, Interest and Money*. Keynes' argument was that the free market was not necessarily the positive force that many, following Adam Smith, believed. Keynes argued that the key to growth was real investment, i.e. investment in new (rather than replacement) infrastructure projects. This investment, he claimed, would have a positive effect on job creation and the further generation of wealth, through the multiplier effect (see Figure 2.2). This effect could, however, also work in reverse, so that declining levels of real investment would lead to a downward spiral into economic crisis.

Unlike the classical economists, Keynes saw a key role for the government in promoting economic growth. Rather than letting the market operate alone, Keynes said that governments could intervene

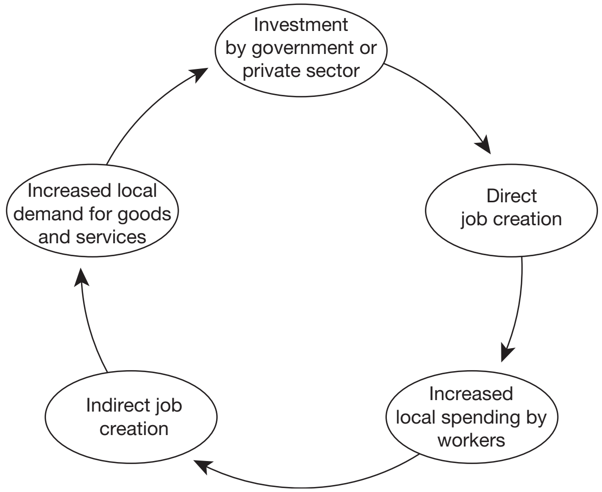

Figure 2.2 Multiplier effect.

to promote investment either through monetary policies such as changing interest rates, or directly through government expenditure. For example, if a government funds a road-building scheme, this will create jobs not only for the road builders, but also for suppliers of road-building materials and tools. The workers will spend money, so supporting other people's jobs, and companies will make profits which can be invested further in productive capital. Government expenditure was, therefore, viewed as a way of 'taming crises' (Preston 1996: 157). This approach was adopted by US President Franklin D. Roosevelt in his 'New Deal' policies of the 1930s in an attempt to boost the US economy and job creation in the aftermath of the Wall Street Crash.

While Keynes did not write specifically on the economic conditions of Southern countries, his ideas regarding government activities were drawn on in the post-war period of development interventions. Policy measures to address the effects of the global economic crisis from 2007 onwards have sometimes drawn on Keynesian ideas, and have therefore been termed 'neo-Keynesianist' (see later in this chapter).

Post-war reconstruction

The post-Second World War period gave Western nations the opportunity to consider the most appropriate forms of international organization and intervention to ensure that the economic crises of the 1930s could never happen again. In addition, they wanted to promote a more peaceful world where warfare could be replaced with diplomacy and negotiation. In the sphere of economics, the 1944 Bretton Woods Conference in New Hampshire, USA led to the creation of three key international institutions aimed at promoting stable economic growth within a capitalist system; the International Monetary Fund (IMF), the World Bank and the General Agreement on Tariffs and Trade (GATT) (see Box 2.1). There were 44 countries represented at Bretton Woods. Although decisions were made which were to influence the whole of the non-communist world, the countries represented were largely from the industrialized world. The nature of representation within global institutions will be discussed further in Chapter 7.

The important role of government, or in the case of the Bretton Woods institutions, multilateral organizations, in economic intervention for development was clearly reflected in the Marshall

Box 2.1

Bretton Woods institutions

All of the organizations are part, in theory, of the United Nations system, but in practice they are autonomous.

International Monetary Fund (IMF) The original aim of the IMF was to maintain currency stability and develop world trade. It continues to do this largely through the provision of support and advice to countries in difficulty. For example, the IMF has been a key institution in the attempts to achieve economic stability after the debt crises of the 1980s and 1990s, the aftermath of the 1997 Asian economic crisis and the global economic crisis from 2008 onwards. As with many international agencies, support for poverty reduction has also become part of its remit.

World Bank Group The term World Bank is usually used to imply one organization, but in fact there are five agencies within the World Bank Group. Of these, the term 'World Bank' is most correctly applied only to the IBRD and the IDA.

International Bank for Reconstruction and Development (IBRD) The IBRD was set up in 1945. Its original aim was to assist in the rebuilding and development of Europe, but following the success of the Marshall Plan (see Box 2.2) the attention of the organization turned to the poorer regions of the world. The IBRD provides loans to national governments of middle income and creditworthy poorer countries at below commercial interest rates. Most of its funds are generated through the world's financial markets. As of July 2010 it had 187 members.

International Development Association (IDA) For the very poorest nations, even interest rates below commercial levels are too high. The IDA was set up in 1960 and provides interest-free loans to the world's 79 poorest countries. Countries have to pay some administration costs, but the IDA provides access to finance that would otherwise be unavailable. Repayment periods are as long as 35–40 years. As of July 2010 it had 170 members and had lent US$207 billion since 1960. It raises most of its money from contributions from its richer country members, although it also receives funds from the IBRD and early repayments.

International Finance Corporation (IFC) Since 1965 the IFC has worked with private sector companies in developing countries to help improve investment levels and business success. By providing loans, business advice and financial guarantees, the IFC helps reduce commercial risks for the private sector.

Multilateral Investment Guarantee Agency (MIGA) Investment in the world's poorer countries is often regarded with suspicion by private sector companies, worried about political instability, restrictions on financial movements and the threat of government expropriation of property. To help the flow of private investment, the MIGA provides a guarantees service. This means that if private sector companies do incur losses for non-commercial reasons, the MIGA will cover those losses. This encourages private sector investment. Since it was established in 1988 MIGA funds have guaranteed over US$21 billion of investment.

The International Centre for Settlement of Investment Disputes (ICSID) The ICSID was set up in 1966 and, like the IFC and MIGA, it seeks to increase the flow of private capital into poorer countries of the world. The Centre provides arbitration in investment disputes and helps promote confidence in dealings between governments and foreign investors.

General Agreement on Tariffs and Trade (GATT) Set up in 1947, the role of GATT was to promote free trade between its members. Originally consisting of 23 members, by the time the World Trade Organization (WTO) replaced GATT in 1995 there were 124 members. GATT worked through a series of negotiations or 'rounds'. During each round, members sought to make agreements about reducing tariffs and extending free trade to new economic sectors. There were eight rounds during the life of GATT.

Sources: Dicken (2007); IMF (2010a); MIGA (2010); Potter *et al.* (2008); Power (2003); Thomas and Allen (2000); World Bank (2010a, c)

Plan, officially titled the 'European Recovery Program'. This was a programme through which aid was channelled from the USA to fund reconstruction in Europe (see Box 2.2). The programme ran from 1948 to 1952 and reflected Keynesian theory in that investment into infrastructure programmes was not just to recreate physical capital in Europe, it was also meant to contribute to kick-starting the national economies of the region. In addition, the US government felt that contributing to this reconstruction would reduce the possibilities of European nations 'succumbing' to Communism.

The role of the USA as a key actor in international reconstruction and development was also reinforced by US President Harry S. Truman in his inaugural speech in January 1949. The theme of the speech is similar to the philosophy underlying the Marshall Plan; poverty and low levels of economic development in other parts of the world are detrimental not only to people living in these conditions, but also to the peace and prosperity of the USA and other more economically developed countries. Truman argued that the USA

Box 2.2

Marshall Plan

The Marshall Plan, also known as the European Recovery Program, was announced on 5 June 1947 by the US Secretary of State George C. Marshall. Under this programme, the US government provided financial assistance to the governments of Western Europe to assist in rebuilding their infrastructure and economies after the Second World War. US motivation for this assistance was more than goodwill. Restored European economies would provide markets for US products and would also contribute to the maintenance of a viable trading system. In addition, given the concerns about the communist threat, the US administration felt that providing this assistance would reduce the likelihood of shifts towards communism within Western Europe.

Between 1948 and 1952 approximately US$17 billion were transferred as part of the Program. At its peak, the transfers represented 2–3 per cent of US GNP; a figure far higher than that for US government development assistance today. Most assistance went to the UK, France, West Germany and Italy. To administer the Program, the Organization for European Economic Cooperation (OEEC) was set up. In 1961 this organization became the Organisation for Economic Co-operation and Development (OECD). Its membership now numbers 32 countries, the original Western European and North American members being joined by Japan, Australia, New Zealand, Finland, Mexico and South Korea. The Czech Republic, Hungary, Poland and the Slovak Republic have also joined following their transition to market-oriented economies. Slovenia became the 32nd member, joining in July 2010.

Sources: Binns (2000); Chenery (1989); OECD (2010); Preston (1996)

should use its technological knowledge to assist poorer parts of the world to improve production levels and therefore the state of economic development and living conditions.

This speech is often held up as the starting point of ‘development planning’. For example, Arturo Escobar, in his influential 1995 book *Encountering Development: The Making and Unmaking of the Third World*, stresses the importance of this speech to the development of a particular discourse and policy-making aimed at the non-industrialized world. Escobar quotes Truman’s perspective:

> For the first time in history humanity possesses the knowledge and the skill to relieve the suffering of these people [the world’s poor] I

> believe that we should make available to peace-loving peoples the benefits of our store of technical knowledge in order to help them realize their aspirations for a better life . . . . What we envisage is a program of development based on the concepts of democratic fair dealing . . . . Greater production is the key to prosperity and peace. And the key to greater production is a wider and more vigorous application of modern scientific and technical knowledge.
>
> (Truman 1949 in Escobar 1995: 3)

For some, as shall be demonstrated later in this chapter, this sharing of technical know-how from North to South was part of a single path of progress to development and modernization. However, for Escobar and other post-development theorists, it represents a Eurocentric approach which fails to recognize the range of societies in the South and also the needs and requirements of the local populations.

Linear stages theory

In 1960, Walt Rostow published *The Stages of Economic Growth: A Non-Communist Manisfesto*. Rostow wrote mainly about 'economic growth' rather than 'development' per se, but he did make distinctions between 'more developed' and 'less developed' areas (1960: 2) and his 'stages of economic growth' were the route to 'more developed' status. Under Rostow's thinking, there was one path to 'development' with the final stage being termed 'Age of High Mass Consumption'. Thus in goal terms, 'development' was conceived of as a state where the mass of the population could afford to spend large amounts on consumer products, the economy was largely non-agricultural and very much urban-based. Finally, the subtitle of Rostow's book *A Non-Communist Manifesto*, stressed that development was to take place in a capitalist context, rather than a communist one. As a process, 'development' was defined in relation to modernity, and to a move from agricultural societies with 'traditional' cultural practices, to a rational, industrial and service focused economy.

In the introduction to his book Rostow is careful to stress the heterogeneity of experiences:

> I cannot emphasize too strongly at the outset, that the stages-of-growth are an arbitrary and limited way of looking at the sequence of modern history; and they are, in no absolute sense, a correct way. They are designed, in fact, to dramatize not merely the uniformities in the

> sequence of modernization but also – and equally – the uniqueness of each nation's experience.
>
> (Rostow 1960: 1)

However, despite this claim, he starts Chapter 2 with 'It is possible to identify all societies, in their economic dimensions, as lying within one of five categories' (1960: 4). To highlight the nature of 'development' as a process, Rostow used the analogy of an aeroplane moving along the runway until it reaches take-off and then soaring into the sky (see Figure 2.3). To demonstrate that this was a route that all countries could take, he provided information about when different countries of the world had reached certain stages (see Table 2.1). Rostow's work, therefore, fitted into the conception of development as being modernity to be achieved through following Western models of 'success'. It is probably the best example of what has been termed 'modernization theory'. The stages-of-growth model also conceived of development and policy-making taking place within state boundaries at a national scale, the assumption being that this was the appropriate scale at which to practise development.

Structural change models

The concept of gradual shifts over time along a particular path was also found within what Michael Todaro (2000) terms 'structural change

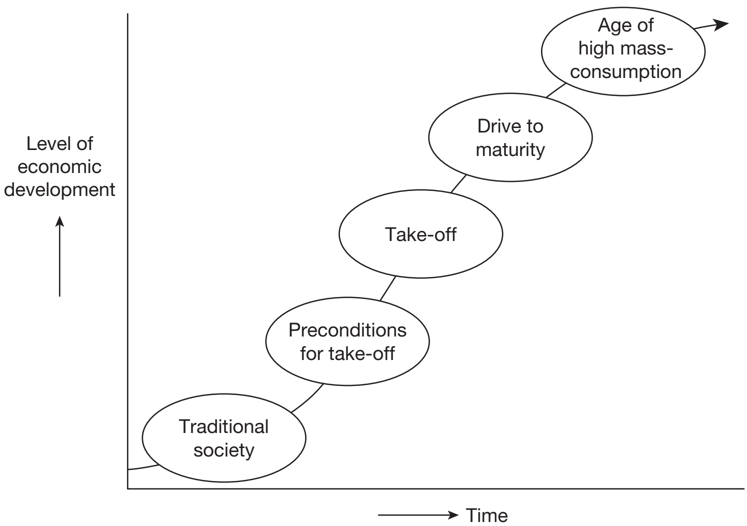

Figure 2.3 Rostow's stages of economic growth.

Table 2.1 ***Rostow's stages of economic growth***

Stage	*Characteristic*	*US Example*
Traditional	Based on agriculture; pre-Newtonian science and technology; family and clan allegiances key; pre-nation-state	**Pre-nineteenth century** Native American subsistence and hunter–gatherer societies; European settlers focus on trade of agricultural goods
Preconditions for take-off	Savings and investment rates above population growth rates; national level organization and institutions; new elites; changes often triggered by external intrusion	**1815–40s** Focus on economic activities after independence gained in 1776; higher productivity in agriculture, e.g. cotton production; large-scale infrastructure projects with government funding, e.g. Erie Canal, railway network
Take-off	Stimulus to take-off needed, e.g. political revolution, technical innovation, changing international economic environment; investment and savings rates 5–10 per cent of national income; substantial manufacturing sector; appropriate institutional arrangements, e.g. banking system	**1843–60** American North 'took off' during this period – American South did not 'take off' until the 1930s. Expansion of railways into Mid-West in 1850s associated with inflow of foreign capital; massive expansion in grain exports; growth of manufacturing in East
Drive to maturity	Extended range of technology adopted; development of new sectors; investment and savings 10–20 per cent of national income	**Maturity reached by 1900** Expansion of steel production; agricultural productivity increased; focused economic development policies
Age of mass high consumption	Widespread consumption of durable consumer goods and services; increased spending on welfare services	**1900s onwards** Rise of middle class as move into urban employment in manufacturing, transport, construction; massive increase in consumer purchases, e.g. cars and cigarettes; increased suburbanization; 1913–14: introduction of Ford assembly lines

Source: adapted from Rostow (1960)

models'. The basic theme of these models of development was how national economies shifted from a rural, agricultural base to an urban, manufacturing one. Thus 'development' was conceived of as a largely economic phenomenon.

The key theorist was W. Arthur Lewis, who used his experiences of growing up in St Lucia to examine the nature of economic development (Szeftel 2006). He conceived of the economy of 'underdeveloped countries' being dualistic, i.e. divided into two. The so-called 'traditional' sector consisted largely of subsistence agriculture, although some forms of urban self-employment could also come under this heading. The 'modern' sector, in contrast, was made up of commercial agriculture, plantations, manufacturing and mining. For Lewis, 'development' took place as surplus labour moved from the non-profit oriented traditional sector to the capitalist modern sector. He argued that because there was so much 'surplus' labour, i.e. unemployed or underemployed people, in rural areas, the wages in the modern sector would not increase until the surplus labour had been absorbed (Lewis 1964). Because of the urban basis of much 'modern' economic activity, the Lewis model was based on large amounts of rural–urban migration.

Lewis was concerned with how countries could begin to develop the 'modern' sector. In particular, how countries could raise enough money for investment when the population was saving very little because there were high levels of poverty. As a way out of this trap, he advocated foreign investment. Governments should encourage foreign companies to invest their capital into domestic industrial development through a process termed 'industrialization by invitation' (Lewis 1955).

Lewis' interpretation of development has been criticized from a number of perspectives. Deepak Lal (1985) claimed that his assumptions about non-changing wage rates in situations of surplus labour were untenable, although John Toye (1993: 104) uses the Indian example to demonstrate that Indian wage rates have not gone up a great deal because the continued availability of cheap labour from the 'traditional' sector has helped keep them low. Other criticisms levelled at Lewis have included his failure to recognize the potential contributions that the subsistence agricultural sector can make to economic development (Binns 2008; Toye 1993). His promotion of 'industrialization by invitation' has also been criticized because it encourages dependence (see Chapter 3).

Plate 2.1 Corn stores, West Pokot District, Kenya.
Credit: Katie Willis

Spatial dimensions

As highlighted in Chapter 1, development has not only a social, but a spatial dimension. Just as the Keynesian forms of development policy were meant to lead to a process of trickle-down to the poorest people in society, so development benefits were meant to spread to different regions. For Albert Hirschman (1958), spatially-unbalanced growth was a desirable part of the development process. Based on his own experiences in Latin America he argued that rather than attempt to achieve equal rates of growth throughout a country, it makes sense to allow economic development, particularly industrialization, to be spatially concentrated. His argument was that these so-called 'growth poles' would act as foci for economic development, but that over time, the benefits of such processes would spread and the degree of polarization would reduce. The idea of a route of progression was therefore clear in Hirschman's work. While he recognized that conditions in poorer countries might require different forms of development approach, the underlying commitment to modernization following the Western experience was evident. 'Behind the ideas of unbalanced growth and growth poles it is . . . easy to recognise the conception of growth as a more or less natural and automatic but occasionally disturbed or interrupted process' (Hettne 1995: 43).

The Swedish economist Gunnar Myrdal (1957) also highlighted the spatial inequalities inherent in free market economic development in his book *Economic Theory and Underdeveloped Regions*. However, unlike Hirschman, Myrdal did not believe that spatial polarization would automatically be reversed once economic development reached a certain level. Using the concept of cumulative causation, he argued that once a region started to grow economically, people, resources and finance would be drawn to that area so contributing to further growth. These flows would leave other areas depleted of dynamic people and resources to contribute to development; this is what Myrdal called 'backwash effects'. He did recognize that some benefits of this spatial focus may extend to neighbouring regions through 'spread effects', but overall the vicious cycle of decline for areas outside the core areas would continue.

For Myrdal, the only way in which the exacerbation of spatial inequalities could be reduced was through state intervention. He argued that if state planning was efficient, there was no need for the regional variations in economic growth rates. However, he was aware that in many situations the government and state departments in many countries were not able to achieve this (Myrdal 1970). He termed such states 'soft states' and advocated a move to 'strong states' to ensure that the planning mechanisms could be implemented. However, he did not provide details on how this was to be achieved. Myrdal's faith in planning as a solution to 'development problems' fits with what the post-development theorists would call a Eurocentric technocratic approach. While Myrdal clearly criticized leaving 'development' to the free market, he remained within a development approach that focused on economic growth.

International aid

Flows of international aid from North to South were part of the development policy responses to modernization theory in the post-war period. The poorer countries of the world were regarded as lagging behind on the path of economic development, being largely agricultural and lacking the autonomous capacity for investment and economic growth. Following this interpretation, large transfers of money, technology and expertise were expected to fill the gaps and help the economic development process. Truman's speech about technology transfer fits within this model.

'Aid' can be defined in a number of ways. It usually refers to 'a transfer of resources on concessional terms – on terms that are more generous or "softer" than loans obtainable in the world's capital markets' (Cassen and associates 1994: 2). These resources are usually transferred from one government to another directly (bilateral aid), or from one government through a multilateral agency or an NGO to governments or groups in poorer countries (Lancaster 1999).

In terms of official reporting of international aid flows, data from the Development Assistance Committee (DAC) of the OECD has often been used to assess the level of 'official development assistance' (ODA). To be classified as ODA, flows must be: 'provided by official agencies, including state and local governments, or by their executive agencies', the main objective must be 'the promotion of the economic development and welfare of developing countries' and it must be 'concessional in character and [include] a grant element of at least 25 per cent' (OECD 2008: 1). However, the growing importance of the so-called 'non-DAC donors', including China, India and oil-producing Gulf States, has radically changed the nature of international aid flows (see later in this chapter and Chapter 7) (Mawdsley 2010).

Aid can include grants and loans, but it can also cover technical advice, transfer of resources such as equipment or food, and debt cancellation (see later in this chapter). It is usual to distinguish between 'emergency aid' or 'relief aid', which is mobilized at times of natural disaster or war to meet immediate needs, and long-term development aid. It is this development aid that forms the bulk of aid flows and which has been used to promote particular forms of development practice.

In the 1950s and 1960s, in particular, aid was channelled into industrial development and projects to improve agricultural efficiency through the use of technology. There was also a focus on large-scale infrastructure projects, such as dam construction and road building (Plate 2.2). This form of 'top-down development' was advocated because policy-makers believed that this development path had worked in the North so could work elsewhere. It did, however, have

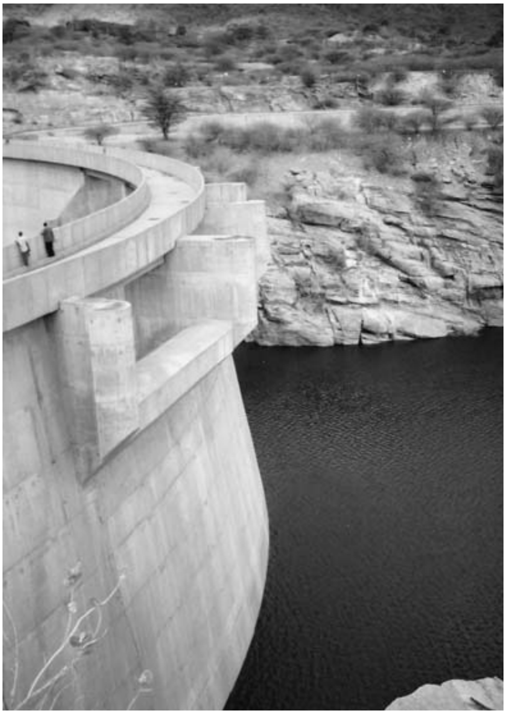

Plate 2.2 Turkwell Dam, Kenya.
Credit: Katie Willis

serious social (Chapters 4 and 5) and environmental (Chapter 6) impacts. The externally-derived nature of this development approach is summed up by General Olusegun Obasanjo, President of Nigeria, 1976–9 and 1999–2007. He stated ‘In education and in industrialization, we have used borrowed ideas, utilized borrowed experiences and funds and engaged borrowed hands. In our development programmes and strategies, not much, if anything, is ours’ (1987 in Lancaster 1999: 3).

A growing awareness of the constraints to the effective use of aid, as well as debates around the role of the market in development and the growing importance of aid donors outside the Global North, has resulted in new approaches to international development aid, which will be discussed at the end of this chapter.

Neoliberalism

From the previous sections it is clear that for most governments in the Global North, as well as multilateral agencies such as the World Bank and International Monetary Fund, ‘development’ in the post-war period was to be achieved through variations on Keynesian approaches. The approach was based on government intervention at a national level and foreign assistance in terms of aid on an international scale. This perspective changed during the 1970s when the role of the state was increasingly questioned.

In the 1970s, some theorists began to argue that the widespread involvement of the state in economic activities, was leading to inefficiency and slower rates of economic growth than would be achieved if the market were left to its own devices. These theorists, such as Deepak Lal (1983) and Bela Balassa (1971, 1981), were drawing on the classical economic theories of Adam Smith and others regarding the 'invisible hand of the market'. For neoclassical or neoliberal theorists, the route to greater economic growth and therefore greater levels of well-being for all, was through reducing state intervention and letting the market set prices and wages. It was argued that this would ensure the most efficient allocation of resources so optimizing growth rates with concomitant social benefits. In relation to aid, Peter Bauer (1972) argued that foreign aid also contributed to the inefficiencies and that this form of intervention should be greatly reduced.

John Toye (1993) describes this shift in theorizing about development as a 'counter-revolution'. He summarizes the three main policy approaches which this counter-revolution wanted to challenge:

- the over-extension of the public sector;
- the over-emphasis of economic policies on investment in physical capital, i.e. infrastructure, rather than human capital such as education and health;
- the widespread use of economic controls, such as tariffs, subsidies and quotas, which distorted prices.

(Toye 1993: 70)

All three of these concerns focus on factors which are internal to a country. There is no consideration of external factors which might influence economic success.

For example, Balassa's work concentrated on the liberalization of trade. Using the cases of four Latin American countries and five Asian countries, Balassa (1971) examined the role of the state in promoting economic growth through industrialization behind tariff barriers. For the period 1950–69, he argued that growth rates in Korea and Taiwan were much higher than in the other seven countries, largely because they adopted an outward-oriented manufacturing export strategy (Figure 2.4). They were adopting the non-protectionist approach that Smith had promoted in the eighteenth century (although see later for further discussion of East Asian development).

By 1983 it was clear that the World Bank had taken on this way of thinking about economic development. In the 1983 *World Development Report*, there was a focus on stressing the relationship between economic growth rates and the degree of state intervention in prices. The implication was that the most rapid growth rates were found in those countries which were most outward-oriented and where states were least involved in 'distorting the market'. However, as Toye (1993: 108) highlights, 'only one-third (or 34 per cent) of the economic performance of these countries is explained by policy-induced price distortions of all kinds. Two-thirds of their economic growth responds to other factors.' There is no consideration of the social and political situations and institutions in these countries which may have affected economic growth, rather the World Bank, following a neoliberal interpretation, prefers to focus on government involvement in economy.

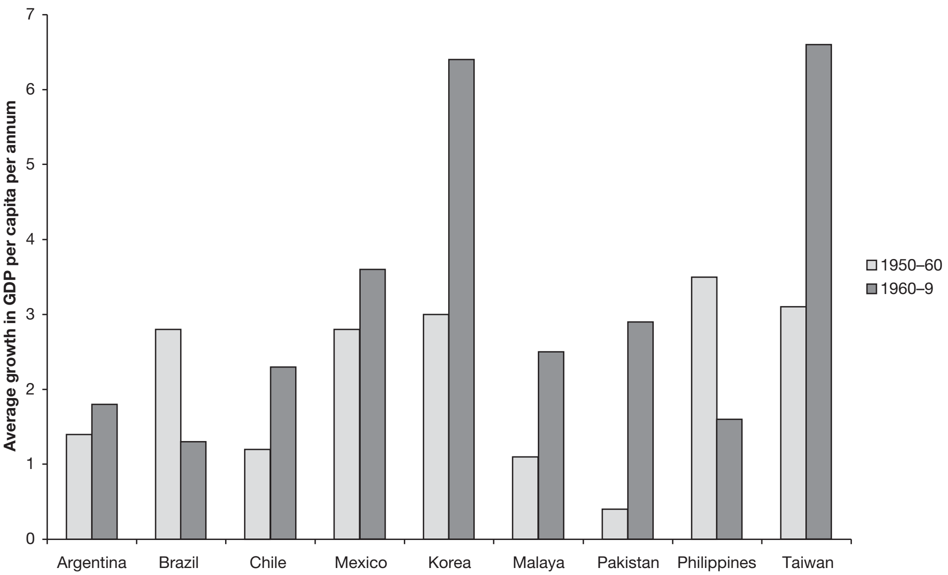

Figure 2.4 GDP per capita growth rates for selected Latin American and Asian countries, 1950–69.

Source: based on data from Balassa (1971: 180)

This move towards a celebration of the market as a neutral resource-allocating system, was found not only in relation to the Global South, but also in the so-called 'Second World' with moves away from state socialism (see Chapter 3) and in the industrialized countries of Western Europe and North America. The United Kingdom under Margaret Thatcher, elected in 1979, and the USA under Ronald Reagan, who took office in 1981, are probably the best examples of this economic philosophy in action.

Debt crisis

The need for an alternative to Keynesian approaches was regarded by some as imperative as economies throughout the world experienced slowing rates of growth in the 1970s. Within many parts of the South, import-substitution policies (see Chapter 3) had been implemented with some success, but the limits of such policies were becoming apparent. These national limits, combined with falling commodity prices and a slow-down in the world economy, led to what has been termed the 'debt crisis' of the 1980s.

The relationship between income coming into a country and that going out is termed the 'balance of payments' (see Table 2.2). These are divided between the current account and the capital accounts. If there is a deficit in one of these accounts, this is not necessarily a problem, as a surplus on the other account may cover the amount. However, if it does not, or if there is a deficit on both accounts, then money must be found to deal with the deficit. This may be found in the cash account, which includes three forms of reserves; foreign 'hard' currencies, such as US dollars, gold and Special Drawing Rights (SDRs) at the IMF. SDRs give the holders the ability to claim currencies from IMF members in the form of loans (IMF 2010c).

The debt crisis arose because many nations of the South were not able to cover their debt repayments (either the interest or the repayment of the amount borrowed). During the 1960s and particularly during the 1970s, many Southern governments borrowed large amounts of money to fund large infrastructure and development schemes. Before the 1970s, most of this borrowing was from Northern governments or from multilateral agencies, but in the 1970s there were increasing levels of borrowing from private banks. This is part of what has been known as the recycling of petrodollars. Because of rising oil prices, countries that were part of OPEC (Organization of Petroleum Exporting Countries) were amassing large amounts of money.

Table 2.2 ***Balance of payments accounts***

	In	Out	
Exports of goods and services	A		
Imports of goods and services		B	
Net investment income[a]	C		
Debt-service payments		D	
Net remittances and transfers[b]	E		
Total current account balance (A – B + C – D + E)			**F**
Direct private investment[c]	G		
Foreign loans (public and private), minus amortization[d]	H		
Increase in foreign assets of domestic banking system		I	
Resident capital outflow (capital flight)[e]		J	
Total capital account balance (G + H – I – J)			**K**
Increase (or decrease) in cash reserve account			**L**
Errors and omissions (L – F – K)			**M**

Source: adapted from Todaro (2000: 542–3)

Notes

a The balance between the earnings on overseas investments (such as bank deposits and bonds) which are brought into the country and investment income and profits which are taken out of the country.

b The balance between private transfers into and out of the country, e.g. money sent back home by nationals working overseas.

c This is made up largely of investment by multinational corporations.

d Foreign loans from private banks, governments and multilateral agencies minus the payments made to pay back part of the sum borrowed.

e Movement of money out of the country to foreign bank accounts, property, stocks and shares purchases; triggered by loss of confidence in the domestic economy.

This was deposited in banks and was then lent to other countries so accruing interest. Southern governments were happy to borrow this money to fund their development projects, and this action seemed sensible as interest rates were low and export earnings from commodities remained at a healthy level.

Unfortunately, in the late 1970s commodity prices fell. As Southern countries earned most of their export revenue from primary commodities, either agricultural products such as coffee or sugar, or minerals such as coal or iron ore, a decline in world commodity prices was catastrophic. This fall in commodity prices was exacerbated by global recession in 1981–2, which led to industrialized countries implementing greater forms of protectionism such as increased import tariffs, again making it harder for Southern countries to export their goods. In addition, interest rates went up and millions of dollars of savings were moved by investors to what were

Table 2.3 ***Debt burden, 1970–92***

	Total external debt as % GNP			*Debt service as % exports of goods and services*		
	1970[a]	*1982*[a]	*1992*[b]	*1970*[a]	*1982*[a]	*1992*[b]
Low-income economies	17.0	18.9	32.1	11.3	8.8	18.9
Low-income economies excluding China and India	20.9	28.7	61.2	5.7	9.9	24.5
Lower-middle-income economies	15.4	27.2	40.0	9.2	16.8	17.8
Upper-middle-income economies	10.8	23.2	30.5	10.7	16.9	18.9

Sources:

a World Bank (1984: Table 16)
b World Bank (1994: Table 23)

regarded as 'safer' countries through the process of 'capital flight'. These events meant that many Southern governments were no longer able to meet their debt repayments, ushering in the widespread implementation of neoliberal policies based on market-centred theories of development (Milward 2000).

In August 1982 the Mexican government announced that it would not be able to meet the repayments on its debt. This triggered the 'debt crisis', although the problems of debt had been increasing throughout the late 1970s. Debt is not necessarily a problem; being unable to repay the debt or meet interest payments is. In addition, having to spend large amounts of export earnings on debt servicing means there is less to spend on welfare programmes and national investment (Table 2.3).

Structural adjustment programmes

Probably the most well-known aspect of neoliberal development theory in practice has been the implementation of structural adjustment programmes (SAPs) since the late 1970s. These policies were often adopted by national governments in return for continuing financial support from the International Monetary Fund and World Bank. The underpinning philosophy of SAPs reflected the market ideologies adopted by the Thatcher and Reagan administrations and their implementation demonstrates the ways in which policies developed in the North could be imposed on Southern nations.

During the late 1970s and early 1980s, national governments found themselves increasingly unable to pay the interest on the debt they had accrued through borrowing both from commercial banks and multilateral organizations.

SAPs encompassed a series of government-led policies which aimed to reduce (not eliminate) the role of the state in the running of the national economy. SAPs usually included two categories of policies which can be classified as stabilization measures and adjustment measures. The first group included policies such as freezing government-sector wages, cutting back on government expenditure and devaluing the currency. Once the economy had been 'stabilized' adjustment measures were introduced to make longer-term changes which would, it was argued, contribute to a more economically prosperous future. Such measures included opening up the national economy to foreign investment, reforms in the tax system and privatization (Simon 2008) (see Table 2.4). Through these policies, government income would be maximized and there would be much greater efficiency and economic growth. Given the debt burdens and the negative rates of economic growth that had been experienced, such policies appeared to hold some hope for development. These policy recommendations are sometimes referred to as reflecting the

Table 2.4 ***Main characteristics of structural adjustment programmes***

Internal policy reforms – to increase role of the market in the domestic economy

- Privatization of state firms – allows for greater competition, reduces drain on state resources if firms doing badly;
- removal of state subsidies – increases competition and reduces state expenditure;
- improvements in tax system – increases state income;
- removal of wage controls, e.g. minimum wages – wage levels should be set by the market;
- reduced government workforce – cuts back on bureaucracy and inefficiency and reduces state expenditure.

External policy reforms – to encourage foreign investment and increasing exports

- Currency devaluation – makes imports more expensive and exports cheaper;
- removal or reduction in tariffs – encourages international trade;
- removal or reduction in quotas, e.g. legal minimum amount of domestically sourced inputs – encourages foreign investment and export;
- end state control of exports, e.g. for agricultural commodities – improves efficiency and encourages private investment.

Source: adapted from Milward (2000)

'Washington Consensus', a term that was originally coined by John Williamson in 1990 to describe the neoliberal policy reforms in Latin America that institutions based in Washington DC, such as the IMF and World Bank, were proposing in the late 1980s. However, it was often used to describe the implementation of neoliberal policies by IFIs throughout the world and as 'a synonym for market fundamentalism' (Williamson 2000: 256).

In the vast majority of cases, SAPs proved to have very serious consequences. The withdrawing of the state, the opening up of the national economy to foreign investment and currency devaluation did not have the desired effect; rather poverty levels increased as real wages went down, unemployment increased and the cost of living rose. The removal of state safety nets in some cases also left the most vulnerable and destitute with no form of assistance (Cornia *et al.* 1987) (Box 2.3). David Simon (1995: 17) argues that the debt crisis is usually associated with Latin America, but the issues of indebtedness, and in particular the role of SAPs, in Sub-Saharan Africa, should not be ignored. Economic stabilization may have been achieved, but the costs in terms of human welfare have been severe (Simon *et al.* 1995).

It is difficult to generalize about the effects of SAPs in social terms, partly because of the diversity of experiences (Stewart 1995), but also because we cannot know what would have happened if SAPs had not been introduced. In some cases (Box 2.3) there is evidence of poverty increases after SAP introduction, '[h]owever, the key point is that it is agreed that although SAPs may not have caused poverty in a direct sense, they certainly did not lead to poverty reduction' (McIlwaine 2002: 99).

Growing awareness of the detrimental social effects of SAPs and the move towards a global poverty reduction agenda, led the World Bank and IMF to reshape SAPs in the late 1990s. Neoliberal adjustment policies are still a key part of the organizations' conditions for lending funds, but greater attention is paid to the needs of the poorest people in society. The diversity of national situations is also acknowledged, compared to the one-size-fits-all approach under SAPs. These new policies are grouped under the heading 'Poverty Reduction Strategies' (PRSs) and a key element is the Poverty Reduction Strategy Paper (PRSP), which was introduced at the end of 1999. The PRSP is a document which each government must produce in order to qualify for further funding. Although it is written

Box 2.3

Structural adjustment in Jamaica

During the 1970s the Jamaican economy experienced severe economic problems including negative levels of economic growth from 1974 onwards. These problems led the Jamaican government under Edward Seaga to sign an agreement with the IMF in 1977 for further funding dependent on Jamaica following adjustment policies. Further agreements with both the IMF and World Bank followed in the 1980s and 1990s.

Government expenditure fell dramatically as part of these policies. The budgeted expenditure for 1985/6 was 71 per cent of the 1981/2 level. While government spending on social services was 641 million Jamaican dollars in 1979/80 this had fallen to 372 million in 1985/6 (based on 1979/80 prices). These declines in government social spending, combined with increased unemployment and falling real wages led to declining standards of living. Levels of infant malnutrition increased, education levels fell and the supply of new housing for low-income groups shrank to almost zero. Between 1980 and 1985, O'Level pass rates fell from 62 per cent to 34 per cent, reflecting the declining investment in school infrastructure and teachers' wages, as well as poor levels of health among children and pressures from families for children to enter paid work.

Overall poverty levels increased during the 1980s, with some annual fluctuations. Using US$60 per month at 1989 prices as the poverty line, the poverty rate increased from 45.5 per cent in 1989 to 54.5 per cent in 1996. Some households were able to maintain living standards, especially those who had access to remittances from family members overseas. The role of women in addressing the effects of declining incomes and rising expenses was particularly important (see Chapter 5 for a discussion of the gendered dimensions of SAPs). Beverley Mullings (2009) also identifies the importance of 'gang welfare' in providing support to residents of particular urban neighbourhoods. SAPs in Jamaica have had serious negative impacts on social development in the country, not only in health and education terms, but also with respect to social breakdown.

Sources: adapted from Boyd (1987); Handa and King (1997, 2003); Mullings (2009)

by national governments, the formulation of the report and policy suggestions should be conducted in consultation with civil society organizations and donors (World Bank 2010b). This is to promote a more participatory approach to national development (see Chapter 5). Despite the change of name, many argue that PRSs are little different from SAPs and that while consultation processes have occurred, the quality of participation in terms of giving marginalized groups a voice has been limited (Bradshaw and Linneker 2003; Lazarus 2008).

The 'Asian miracle'

The experiences of the East Asian nations from the 1960s to the 1990s were regarded as evidence of how neoliberal policies could lead to development. Not only did these nations experience high levels of economic growth, but this was associated with improvements in living standards and did not result in increasing levels of economic and social inequality (Figures 2.5 and 2.6). The economic development of the region has been represented as a series of waves. Following the success of the Japanese economy in the post-war period, the newly-industrializing countries or economies (NICs or NIEs) of Hong Kong, Singapore, Taiwan and South Korea experienced rapid economic growth based largely on labour-intensive manufacturing industries. In the 1980s this trajectory was also taken by Indonesia, Thailand and Malaysia, as well as China and Vietnam, which were starting to move away from a state-controlled economy (see Chapter 3).

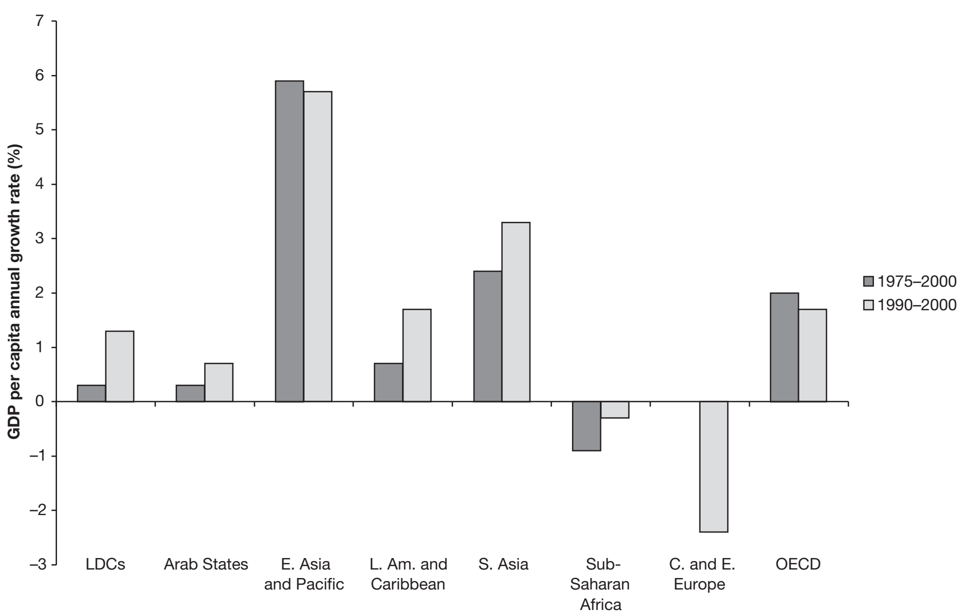

Figure 2.5 Economic growth rates by world region.

Source: based on data from UNDP (2002: 192–3)

High economic growth and low income inequality China Hong Kong Indonesia Japan Singapore South Korea Taiwan Thailand	**High economic growth and high income inequality** Botswana Gabon Malaysia Mauritius
Low economic growth and low income inequality Austria Australia Bangladesh Belgium France India Italy Malawi Mauritania Nepal Pakistan Spain Sri Lanka Switzerland UK	**Low economic growth and high income inequality** Argentina Bolivia Brazil Chile Colombia Ghana Ivory Coast Kenya Mexico Peru Philippines Sudan Venezuela Zambia

Figure 2.6 Economic growth and income inequality, 1965–89.

Source: adapted from Page (1994: Figure 2)

Notes: High economic growth: increase in GDP p.c. of 4% p.a. or above. High income inequality: richest 20% have over 10 times income share of poorest 20%.

In 1993 the World Bank published *The East Asian Miracle*. This book sought to highlight the ways in which economic and social development had been achieved by the East Asian nations by following a few key neoliberal tenets, notably, opening up the economy to foreign investment and trade; limited role of the state in the national economy; investment in human capital, especially education. The book presented this ‘East Asian model’ as a blueprint for economic development with equity in other regions of the world. As Dixon (1999: 206) highlights: ‘the successful Pacific Asian economies have been presented as the living embodiment of neoliberal orthodoxy and examples to be followed by the Third World as a whole.’

Following its publication, numerous commentators queried the validity of the interpretation that the World Bank had made of the post-war economic development in the East Asian countries. Four main criticisms were levelled at the World Bank interpretation. First, that rather than being a coherent set of policies throughout the region, in fact there were a range of approaches adopted within individual countries (Rigg 2003). Second, and very importantly, many criticized the way in which the World Bank used the East Asian experience to promote the benefits of free trade and open economies. In fact, as numerous authors stressed, many of the East Asian countries had achieved their economic success through important government interventions, such as the protectionist policies around Hong Kong's textile industry (Amsden 1994). Third, the World Bank report failed to acknowledge the continued levels of poverty and inequality in the region's nations. Finally, the use of the term 'miracle' suggested an unexplainable process, whereas policies promoting capital accumulation, improving technology and investing in education and training could all be identified as contributing to economic growth (Garnaut 1998).

Plate 2.3 The Petronas Towers, Kuala Lumpur, Malaysia.

Credit: Katie Willis

In 1997 this model of neoliberal economic development collapsed in what was termed the 'Asian Crisis'. The trigger for the economic crisis was the devaluation of the baht, the Thai currency, but there had been cracks appearing throughout the region's economies before this. The crisis was largely financial, in that the withdrawal of large amounts of foreign capital from the region meant that for many countries, the stability of their economies was severely threatened. In 1996, foreign investors' confidence in the Thai economy was shaken by declining export growth and there were also concerns about the large size of the current account deficit. As financial capital was withdrawn from Thailand, investors also lost confidence in other regional economies so capital flight spread (Poon and Perry 1999). This had devastating effects on the levels of economic growth, and also on the levels of poverty among the mass of the populations. Of course, while the crisis spread throughout the region, the experiences were different and some countries weathered the storm much more effectively than others: Indonesia, Thailand and South Korea all experienced negative economic growth rates following the crash, while Taiwan and Japan experienced little change in GDP growth rates (Garnaut 1998).

For the World Bank and other institutions and governments which had held up East Asia as *the* model for successful development policies, the 1997 Asian crisis was certainly a blow. However, World Bank interpretations of the causes of the crisis focused on the failure of the region's governments to follow the neoliberal approach properly. State intervention in the economy which had not been greatly acknowledged in *The East Asian Miracle* was now recognized as a key element in the creation of the crisis (Dixon 1999). Throughout the region, IMF 'rescue packages' were implemented. These were very similar to structural adjustment policies and included conditions such as increased openness to foreign ownership in the banking and financial sectors.

Good governance

The IMF and World Bank, through SAPs, 'rescue packages' and other activities, attach conditions to the loans they provide. This concept of 'aid conditionality' is also part of government aid whether bilaterally or through multilateral organizations, such as the EU. For the IFIs and the DAC donors (see above) the importance of 'good governance' has increased since the 1990s (Weiss 2000).

'Good governance' originally focused on the operation of the public sector and fitted very well within the neoliberal policies of reducing state involvement in the economy. This still remains important and includes processes such as civil service reform, improvements in budgetary management and building capacity of government staff (Harrison 2005). It also attempted to make the accounting process as transparent as possible to reduce corruption and the misappropriation of aid funds. While this transparency was primarily part of making governments accountable to donors, IFIs argued that governments should also be more accountable to their populations. Thus good governance reforms would make government bodies more accessible and responsive to the population's demands. This is part of the growing focus on participatory development (see Chapter 4).

From an original focus on reforming government activities as part of neoliberal economic restructuring, 'good governance' has expanded to include broader themes such as multi-party elections, freedom of the press and respect for human rights. Following the end of the Cold War (see Chapter 3), Northern governments no longer felt the need to support 'undemocractic' governments on geopolitical grounds. The World Bank has six governance indicators, including voice and accountability, political stability and the absence of violence and government effectiveness (World Bank 2010f).

The importance of these good governance indicators can be seen in the conditions applied to countries eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. This was launched in 1996 by the IMF and the IDA (see Box 2.1). In return for meeting certain conditions, including the PRSP process and appropriate governance reforms, the debt burden of the economically poorest countries of the world is reduced. As of August 2010, of the 40 potentially eligible countries, 28 were receiving support (HIPC 2010).

The HIPC initiative represents a continuation of development policies implemented by Northern-based IFIs in Southern countries. However, development assistance and aid is increasingly coming from non-Northern sources with the rise of the BRICs and the oil-producing states of the Middle East. For example, Brazil's foreign aid programme included US$1,200m in bilateral and multilateral aid in 2010 and US$3,300m in loans between 2008 and the first quarter

Plate 2.4 UNICEF-funded school project, Mulanje, Malawi.

Credit: Katie Willis

of 2010 (*The Economist*, 17 July 2010a). While Brazil's aid tends to be focused on social programmes and agriculture, Chinese assistance is channelled into infrastructure projects. There are usually conditions attached to all development assistance, regardless of source, but the 'good governance' is often not part of non-DAC donor conditions (Mawdsley 2008; Six 2009).

Global economic crisis and neo-Keynesianism

Just as the Asian financial crisis of 1997 challenged prevailing ideas about neoliberalism, so the global economic crisis of 2007 onwards has generated much debate about the nature of neoliberalism and appropriate strategies to achieve sustained economic growth. The crisis was triggered by a collapse in the US sub-prime mortgage market, but soon spread throughout the world because of the way in which financial products were sold and resold as part of global financial transactions (Aalbers 2009). Global trade fell as national economies contracted, leading to increases in unemployment and further reduction in demand for goods and services due to the multiplier effect. For example, in May 2009 an estimated 23 million migrant workers in China were unemployed, of whom 14 million had returned to their villages (Branigan 2009).

For Marxist theorists (see Chapter 3), this economic crisis was an inevitable outcome of the operation of neoliberal capitalism (Harvey 2010). However, for those supporting a pro-market approach, the crisis reflected poor regulation of the financial system, rather than an inherent problem with neoliberalism. The international response to the crisis focused on improving regulation, but also involved significant additional government expenditure intended to stimulate the economy (Box 2.4). This reflects a form of Keynesian economic policy, so has been termed 'neo-Keynesianism'.

The G20 grouping (19 economically dominant countries and the EU) agreed at summits in Washington in 2008 and London in April 2009 to promote government spending and increased support for the IMF to help countries in difficulty. However, by the June 2010 Toronto G20 summit, divisions within the G20 were apparent, with some countries continuing to support economic stimulus and others promoting cutbacks in government spending to reduce deficits. As of August 2010, the outcomes of such policies are unknown, but this demonstrates the continued debates around the role of government in economic development.

Box 2.4

Economic stimulus in the USA

While there had been problems in the housing markets in the USA in previous years, it was in 2007 that the number of housing repossessions increased greatly. By the end of 2007 about 4 million people had lost their homes because they were unable to pay their mortgages. House prices fell throughout the country and banks were increasingly under threat of collapse because they could not cover their financial liabilities.

The US government responded by launching a series of measures which involved pumping large amounts of federal money into the economy. By the end of 2009 it was estimated that the economic stimulus package amounted to US$1.7 trillion. This included US$600 billion to support the financial institutions. It was argued that the government could not allow all the Wall Street banks to collapse as this would be catastrophic for the US economy. Critics argued that the banks should be allowed to fail as the financial crisis was a result of bank misconduct.

In addition to the 'banking bailout', the Bush administration spent US$170 billion in 2008 and the Obama administration spent US$780 billion in 2009 in an attempt to encourage spending, job creation and overall economic growth. Policies included subsidies for homebuyers and tax refunds. Despite this spending, unemployment in 2010 remained at around 10 per cent, but it is not known what levels it would have reached without this additional money in the economy.

Source: adapted from *The Guardian* (28 July 2010, 30 July 2010) (Harvey 2010)

Summary

- **Classical and neoclassical economic theories stress the importance of the free market for development.**
- **Modernization theories argue that development is largely economic and the same development path should be followed by all countries.**
- **Post-Second World War, Northern countries focused on providing assistance to Southern countries to help them follow the same development path taken by the North.**
- **Neoliberal policies involving reduced state involvement and a greater role for the market have dominated international development policy since the 1980s.**

- **Good governance has become an increasingly important condition of international development assistance and explanation for successful development policies.**

Discussion questions

1. According to classical economic theories, what are the benefits of free trade?
2. What are the stages of Rostow's linear stages theory and how do countries move from one stage to another?
3. What role did Keynes think the state had in promoting economic development?
4. How and why have neoliberal theories come to dominate international development practice?
5. What is 'good governance' and what role does it play in development theory and policy?

Further reading

Harvey, D. (2007) *A Brief History of Neoliberalism*, Oxford: Oxford University Press. A very clear discussion of the rise of neoliberalism and its implementation in both Northern and Southern countries.

Mohan, G., E. Brown, B. Milward and A.B. Zack-Williams (2000) *Structural Adjustment: Theory, Practice and Impacts*, London: Routledge. An accessible account of the background to structural adjustment, what it involves and the political, economic, social and environmental impacts. There is also a consideration of alternatives to structural adjustment.

Toye, J. (1993) *Dilemmas of Development*, 2nd edition, Oxford: Blackwell. A very detailed examination of the shift from Keynesian approaches to economic development to neoliberal ones. Some students may find the economic content rather hard-going at times, but the book is an excellent overview of these debates.

World Bank (1993) *The East Asian Miracle*, Oxford: Oxford University Press. Excellent example of IFI approaches to economic development in the late 1980s and early 1990s.

Useful websites

www.adamsmith.org The Adam Smith Institute, which aims to increase awareness of the work of Adam Smith and the role of market-led economic development.

www.brettonwoods.org Bretton Woods Committee. Provides information about international financial matters and the role of the IMF, World Bank and WTO in global economic policy.

www.g20.org Website of the G20. It includes information about G20 activities in relation to the global economic crisis.

www.imf.org International Monetary Fund. Provides information on the approaches and activities of the IMF.

www.londonsummit.gov.uk G20 London Summit website. Provides information about agreements regarding a global plan for economic recovery.

www.oecd.org Organisation for Economic Co-operation and Development. Provides information about the organization's activities, including official development assistance.

www.usaid.gov United States Agency for International Development.

www.worldbank.org World Bank. Details the activities of all members of the World Bank Group.

www.worldbank.org/wbi/governance World Bank governance and anti-corruption website.

www.worldbank.org/hipc Highly Indebted Poor Countries (HIPC) initiative.

www.worldbank.org/poverty/strategies Poverty reduction and equity site of the World Bank. Provides information about PRSPs as well as the broader poverty alleviation policies adopted by the World Bank.