ECONOMICS OF DEVELOPMENT

TENTH EDITION

A.P. THIRLWALL
and
PENÉLOPE PACHECO-LÓPEZ

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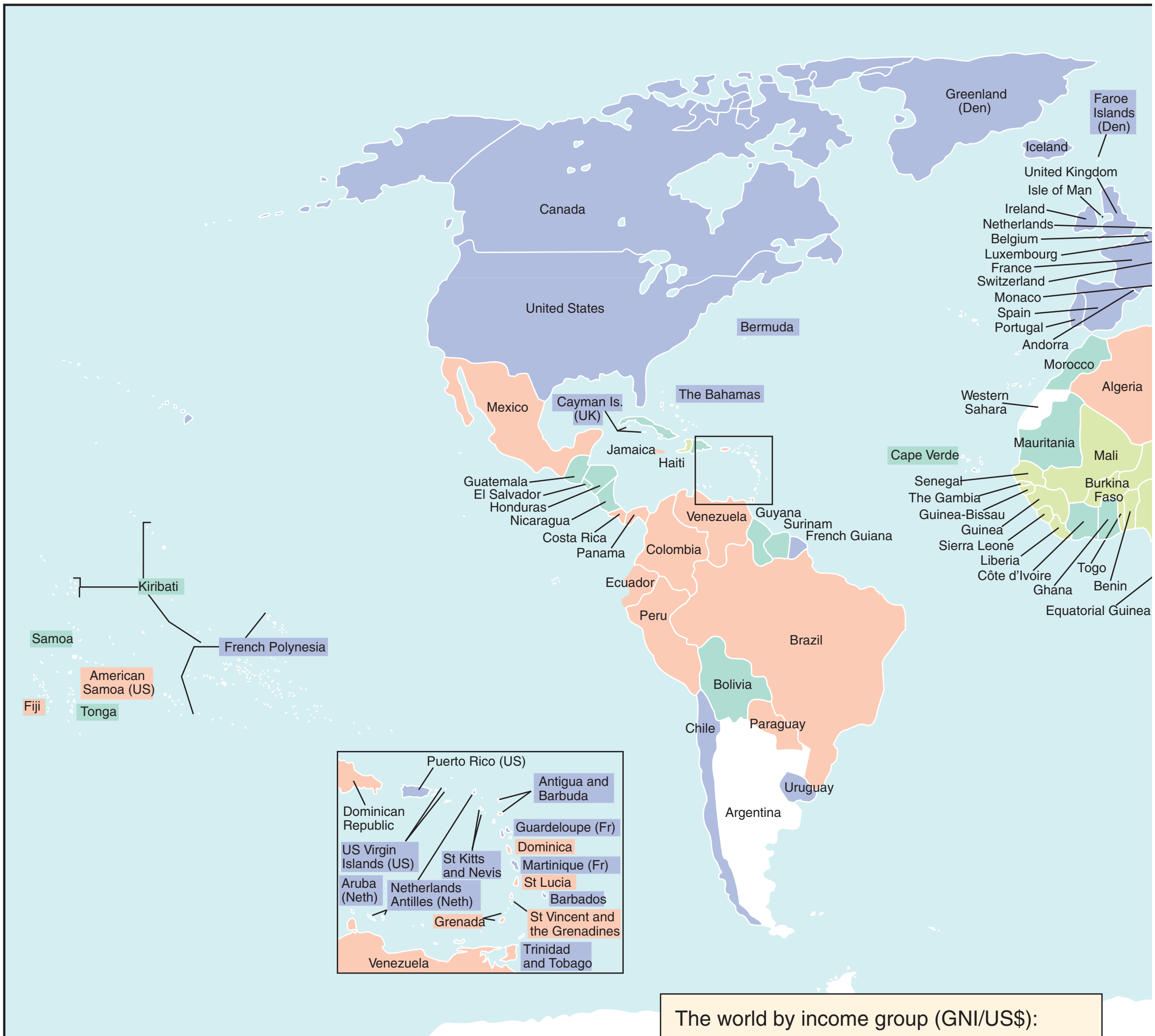

Source: International Bank for Reconstruction and Development, the World Bank

The world by income group (GNI/US$):

Low Income < $1025

Lower-middle Income $1026–$4035

Upper-middle Income $4036–$12,475

High Income > $12,476

No data

Income group classified according to the 2015 GNI per capita, calculated using the World Bank Atlas method.


Norway
Sweden
Finland
Estonia
Latvia
Lithuania
Denmark
Germany
Belarus
Russian Federation
Ukraine
Moldova
Kazakhstan
Mongolia
Georgia
Azerbaijan
Uzbekistan
Kyrgyz Rep.
Turkey
Armenia
Turkmenistan
Tajikistan
Dem. People's Rep. of Korea
Japan
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Singapore
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Dem. Rep. of Congo
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Tanzania
Comoros
Seychelles
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Angola
Zambia
Mayotte
Fiji
Vanuatu
Namibia
Zimbabwe
Malawi
Mauritius
Botswana
Madagascar
Reunion (Fr)
Australia
New Caledonia (Fr)
Mozambique
South Africa
Swaziland
Lesotho
New Zealand
Germany
Poland
Czech Republic
Slovak Republic
Ukraine
Austria
Hungary
Slovenia
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Croatia
San Marino
Bosnia and Herzegovina
Serbia
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Bulgaria
Italy
FYR Macedonia
Albania
Greece

ECONOMICS OF DEVELOPMENT

THEORY AND EVIDENCE

TENTH EDITION

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Penélope Pacheco-López

Consultant to Development Agencies

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To Oliver
from
Mum and Dad

A PERSONAL MESSAGE FROM THE AUTHORS

(Courtesy of Spencer Scott of the University of Kent photographic unit)

The economic and social development of poor countries and reducing divisions in the world economy between rich and poor are two of the greatest challenges facing mankind. Vast differences in income and wealth between countries and peoples are not only morally indefensible but also pose a grave threat to peace and stability in the world.

John Maynard Keynes, the great English economist, once described what drew him to economics; he said, it was 'its intellectual rigour combined with its potentiality for good'. He treated the subject of economics as a moral science, the purpose of which is to understand economic behaviour and thereby be able design policies to make the world a more civilized place in which to live. It is this 'potentiality for good' that attracts so many of today's top economists to development economics.

We have written this textbook on the economics of development so that students can apply their knowledge of economics to the plight of poor developing countries in the hope that they will better understand the divided world in which we live and think about issues of development in whatever capacity they may subsequently work.

We have been teaching and practising development economics for many years and have encountered thousands of students in different parts of the world and from different countries, many of whom have gone on to work in the development field – as employees in international institutions and nongovernmental organizations concerned with economic and social development, or as teachers and researchers in poor countries. If new generations of students studying development economics are inspired to do the same, this volume will have achieved its purpose.

We hope you will enjoy the book, and that when you reach the end, you will feel that the study of the economics of development has enriched your experience as an economist and as a citizen of the world.

Wherever you live, we wish you good luck in your studies.

Anthony Thirlwall and Penélope Pacheco-López

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PREFACE

The first edition of this book was published in 1972 and was entitled *Growth and Development: with Special Reference to Developing Economies.* After eight editions, in 2011, the title of the ninth edition was changed to *Economics of Development: Theory and Evidence* to reflect more accurately the contents of the book, which elaborates the theory of economic development, combined with empirical evidence on the functioning of developing countries in the world economy with respect to the important mainsprings of growth and development, such as capital formation, technical progress, institutions, national and international finance, trade, and particularly export performance.

This new edition of the book, now jointly with Dr Penélope Pacheco-López, who has worked in many international economic organizations, gives the opportunity to substantially revise the content of the book, to update statistics, and rewrite chapters to include new theoretical ideas and institutional material in order to improve the exposition to aid students and teachers alike.

But the purpose of the book remains the same: to introduce students to the exciting and challenging subject of development economics, which draws on several branches of economics in order to elucidate and understand the development difficulties facing the economies of the world's poor developing countries. This does not mean that the book provides a recipe or blueprint for development: far from it. There can be no general recipes of this nature, and even if there were, they would have to include more than economic ingredients.

The book combines description and analysis, with an emphasis on the elaboration of simple and useful theoretical economic models for an understanding of the issues that comprise the subject matter of development economics. We make no apology for the use of conventional economic theory. We concur with Theodore Schultz (1980), Nobel Prize-winning economist, who has said of development economics:

> This branch of economics has suffered from several intellectual mistakes. The major mistake has been the presumption that standard economic theory is inadequate for understanding low income countries and that a separate economic theory is needed. Models developed for this purpose were widely acclaimed until it became evident that they were at best intellectual curiosities. The reaction of some economists was to turn to cultural and social explanations for the alleged poor economic performance of low income countries. Quite understandably, cultural and behavioral scholars are uneasy about this use of their studies. Fortunately, the intellectual tide has begun to turn. Increasing numbers of economists have come to realize that standard economic theory is just as applicable to the scarcity problems that confront low income countries as to the corresponding problems of high income countries.

This is not to say, of course, that *all* standard theory is useful and relevant for an understanding of the development process; in particular, the relevance of static equilibrium theory may be questioned. Nor is it possible to ignore non-economic factors in the growth and development process. The fact is, however, that the desire for material improvement in developing countries is very strong, and, in the final analysis, growth and development must be considered an economic process, in the important practical sense that it is unlikely to proceed very far in the absence of an increase in the quantity and quality of the resources available for production. The book lays particular emphasis on the economic obstacles to development and the economic means by which developing countries may raise their rate of growth of output and living standards in order to reduce poverty.

For those new to the book, or for those using the ninth edition, we outline the main contents of each chapter and the changes introduced into this tenth edition.

Part I Development and underdevelopment comprises four major chapters that provide a basis for understanding the nature of poverty and underdevelopment in low-income countries, and the theories of economic growth and development that have been put forward over time. This part constitutes important background for the rest of the book.

Chapter 1 addresses the subject of development economics, the meaning of development and the challenge of development economics. The globalization and interdependence of the world economy is emphasized, and there is discussion of the call for a new international order, including the new Sustainable Development Goals, agreed in 2015.

Chapter 2 portrays the magnitude of the development gap between rich and poor countries in the world economy and discusses the measurement of poverty, including the Human Development Index (HDI) of the UN Development Programme (UNDP) and the Multidimensional Poverty Index (MPI) of the Oxford Poverty and Human Development Initiative. There is also a new section on randomized control trials (RCTs) for understanding the best way to reduce poverty. There is a discussion of the World Bank's approach to tackling poverty based on the ideas of empowering the poor and extending their capabilities, as discussed in its *World Development Report 2000/2001*. New research is also reviewed on whether the global and international distribution of income is widening or narrowing.

Chapter 3 outlines the characteristics of underdevelopment and gives quantitative evidence of various dimensions of the development gap with respect to employment and unemployment, hunger and the distribution of income within countries. The major characteristics of underdevelopment identified include the dominance of low-productivity agriculture and lack of industrialization, low levels of capital accumulation, rapid population growth, an export trade dominated by primary products, the 'curse of natural resources' and weak governance and institutions. These topics are discussed more fully in later chapters. The process of structural change is also addressed, as is the notion of industrialization as the engine of growth.

Chapter 4 introduces students to various economic growth theories. There are sections on classical growth theory (Adam Smith, Malthus, Ricardo and Marx), the Harrod–Domar growth model, neoclassical growth theory, and the 'new' endogenous growth theory that now dominates the literature on the applied economics of growth, with its stress on the importance of physical and human capital formation and research and development effort as the prime determinants of growth. Many empirical studies are surveyed, with regard to the production function approach to understanding the growth process and the macrodeterminants of growth approach using 'new' growth theory. There is also discussion of the work of Hausmann, Rodrik and others on growth accelerations, and the concept of 'growth diagnostics' and binding constraints on growth. If you find the technical details too difficult, you should proceed straight to Chapter 5, but you will be missing a lot.

Part II Factors in the development process contains five chapters: the role of agriculture and surplus labour in developing countries; the role of capital accumulation and technical progress for growth; a new chapter on human capital – education, gender, nutrition and health; the importance of institutions conducive to development; and the role of the state in economic development.

Chapter 5 deals with the different contributions that agriculture makes to the development process, one of which is a source of cheap labour for industry. Particular attention is paid to the influential Lewis model of economic development with unlimited supplies of labour. There is explicit treatment, following on from Lewis, of the interaction and complementarity between agriculture and industry, with a number of interesting insights into the importance of demand expansion from agriculture as a stimulus to industrial growth and of achieving an equilibrium terms of trade between the two sectors. There is also a discussion of barriers to raising agricultural productivity, highlighted by the World Bank's *World Development Report 2008: Agriculture for Development*. There is an Appendix on how markets function in the rural agricultural sector, and how the land, labour and credit markets interlock, based on uncertainty of agricultural output and the risk aversion of agents.

Chapter 6 explores the role of capital accumulation and technical progress in the development process. The choice of appropriate techniques of production is also explored, and the potential conflicts involved in moving towards the use of more labour-intensive techniques – between employment and output and between employment and saving. The role played by multinational corporations in dictating technological choice is also examined.

Chapter 7 is a new chapter on the role of education, women, nutrition and health in the development process. An educated, skilled and healthy workforce of men and women is vital in the production process to absorb new technology and for working efficiency.

Chapter 8 discusses the role of institutions in the development process. The importance of property rights and the rule of law is particularly emphasized, and the various institutions for regulating markets and providing social insurance. The important work of Rodrik on democracy is reviewed, and also the pioneering work of Acemoglu, Johnson and Robinson on the relationship between institutional development in colonized countries in the past and institutions today, and the debate on the importance of institutions versus geography in explaining differences in economic development.

Chapter 9 explores the role of the state in economic development and its role in resource allocation compared to reliance on the market mechanism. Market imperfections, market failure and corruption are highlighted, as are the limited capabilities of the state, drawing on the extensive analysis contained in the World Bank's *World Development Report 1997*. Some of the broader issues of development strategy are also considered, including the case for planning. There is a revised section on failed states, conflict and violence.

Part III The perpetuation of underdevelopment comprises three chapters that focus on factors that can perpetuate underdevelopment, including poverty itself (causing a vicious circle), rapid population growth and the impact of development on the environment.

Chapter 10 explores dualism and Myrdal's concept of the process of circular and cumulative causation, and describes the mechanisms by which economic divisions between regions and between countries tend to be perpetuated and widened. It includes the early centre–periphery models of Prebisch and Kaldor, together with discussion of the new economic geography pioneered by Krugman. The views of Marxist writers, including Emmanuel's model of unequal exchange, are also presented.

Chapter 11 discusses population and development and attempts to evaluate the debate on whether population expansion is a growth-inducing or growth-retarding force. The costs and benefits of population growth are examined, together with the different ways an optimum population may be defined. The facts on population growth are clearly outlined, with a discussion of the determinants of fertility.

Chapter 12, written by our colleague Professor Iain Fraser, discusses how environmental issues may be incorporated into social cost–benefit analysis, and the new and important concept of sustainable development, which is the subject of the World Bank's *World Development Reports 1992*, *2002* and *2010*. There are sections on the Stern Review on climate change, the impact of climate change on the poor, and the outcome of the climate change conference in Paris in December, 2015.

Part IV Financing economic development covers domestic and foreign resources.

Chapter 13 deals with the financing of development from domestic resources. There is discussion of the theory of financial liberalization, together with critiques and empirical evidence of the relation between real interest rates, saving, investment and growth. There is new material on the financial system in developing countries and the relationship between financial development and economic development. Fiscal policy and taxation are also discussed, together with the topic of forced saving through inflation. New research is reported on the relation between inflation and growth, and the impact of inflation targeting.

Chapter 14 discusses the finance of development from external resources. All the statistics relating to foreign resource inflows have been updated, including the importance of remittances from abroad. The whole aid debate is reviewed, and the impact of aid on development. There are sections on the macroeconomic impact of aid and the critics of aid. Structural adjustment lending by the World Bank and the role of foreign direct investment in the development process are examined. The debt-servicing problems created by foreign borrowing are thoroughly surveyed, and there is extensive discussion of international debt and the concept of optimal borrowing.

Part V Trade, the balance of payments and development contains two chapters.

Chapter 15 discusses trade theory, trade policy and economic development. The static and dynamic gains from trade are thoroughly explored (including the theory of customs unions and free trade areas), as are the ways in which the present pattern of trade works to the relative disadvantage of poor countries. The tendency of the terms of trade to deteriorate and for balance of payments difficulties to arise are stressed. There are sections on the theory and practice of trade liberalization, and the impact that trade liberalization has had on export growth, import growth, the balance of payments, economic growth, domestic income inequality and international inequality. What trade policies poor countries should pursue are also examined, and the arguments given for various forms of protection.

Chapter 16 explores the important concept of balance of payments constrained growth and the various policy responses to this constraint at the national and international level. The latter involves a consideration of the extensive facilities afforded by the International Monetary Fund (IMF) for balance of payments support. Some of the criticisms levelled at the IMF are also considered. There is an analysis of the different types of exchange rate systems that developing countries can adopt, and lessons to be drawn from the financial crisis in East Asia in 1997. The chapter ends with a discussion of Special Drawing Rights as a potential form of international assistance to developing countries.

This new edition continues to provide the addresses of websites, chapter by chapter, to guide students to relevant information and data on the internet. When the next edition of this book becomes due in 2022, the facts pertaining to developing countries will again be out of date, and no doubt there will have been new institutional changes and innovations in thinking about development strategy. To keep abreast with what is going on, students are encouraged to consult publications such as the World Bank's *World Development Report*, the IMF's *Finance & Development* (a quarterly magazine published in several different languages), *The Human Development Report* (published by the UN Development Programme) and *The Least Developed Countries Report* and *Trade and Development Report* (published by the UN Conference on Trade and Development), as well as journals such as *World Development*, *Journal of Development Studies*, *Journal of Development Economics*, *Journal of International Development*, *Economic Development and Cultural Change*, *Oxford Development Studies* and the *World Bank Economic Review*.

Please visit the book's website, www.palgravehighered.com/Thirlwall-Econ-Of-Dev-10e, which contains PowerPoint slides for lecturers, as well as web links to additional resources and videos.

Also, visit the authors' websites: www.kent.ac.uk/economics/staff/profiles/tony-thirlwall.html and www.kent.ac.uk/economics/staff/profiles/penelope-pacheco-lopez.html.

Reference

Schultz, T.W. (1980) 'The Economics of Being Poor', *Journal of Political Economy*, 88: 639–51.

UNIVERSAL DECLARATION OF HUMAN RIGHTS

On 10 December 1948, the General Assembly of the United Nations adopted and proclaimed the Universal Declaration of Human Rights. Since then, it has been translated into more than 350 languages worldwide and more than 100 African languages. There are 30 Articles, but we would like to highlight this one in particular:

> Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and the necessary social services and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control. (Article 25)

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I

DEVELOPMENT AND UNDERDEVELOPMENT

1

THE STUDY OF ECONOMIC DEVELOPMENT

- Introduction
- Development economics as a subject
- Academic interest in development
- The new empirical development economics
- A new international economic order
- Sustainable Development Goals
- Globalization and interdependence of the world economy
- The meaning of development and the challenge of development economics
- The perpetuation of underdevelopment
- Summary
- Discussion questions
- Websites

Introduction

We ask the reader (especially the young student) to consider, behind a veil of ignorance (Rawls, 1972), what sort of world they would prefer to have been born into. A world in which nearly a billion people live on less than $1.90 a day (the official World Bank poverty line), with only a 5% chance of living a luxurious lifestyle or in a fairer world that provides a decent living standard for everyone wherever they are born – whether in Norway, the richest country, or Burundi, the poorest? Whatever answer you give, you will have shown an interest in **development economics**, which seeks to understand and explain why some countries are poor and others rich, and how to reduce poverty in poor countries to give everyone on the planet a minimum standard of life and freedom from hunger and fear of the future.

Development economics, as it is understood and taught today, is a relatively new subdiscipline of economics dating from the early years after the Second World War; but, in fact, the economic progress of nations has always been at the heart of economic enquiry, at least since the time of the great classical economists of the late eighteenth century and the first half of the nineteenth century – Adam Smith, Thomas Malthus, David Ricardo, John Stuart Mill and Karl Marx. These writers were all concerned with understanding the growth and development process of countries and the factors determining the distribution of income between classes of people. Modern development economics has, in many ways, revived the old interests of the classical economists concerning the importance of saving, investment, capital accumulation, trade, and the mobilization of surplus labour for structural change out of agriculture into manufacturing industry and service activities.

In this chapter we start by considering development economics as a subject – and academic interest in development issues – and why there has been a revival of development economics in the past 70 years, with many of the world's best economists researching and writing on development matters. One of the major contributory factors has been the poorer countries of the world calling for a fairer deal from the functioning of the world economy, which they view as being biased against them. This demand for a **new international economic order** has been endorsed by all the major multilateral agencies established after the Second World War to oversee international relations and a smoother functioning of the world economy after the economic chaos of the prewar era: the United Nations (UN) and its several affiliates, the World Bank for Reconstruction and Development and the International Monetary Fund (IMF). We shall discuss what a new international economic order might consist of, and the components of the new **Sustainable Development Goals** laid down in 2015, to be achieved by 2030, which replaced the Millennium Development Goals 2000–15.

Another major factor responsible for the growing interest and concern with developing countries, and the process of economic development itself, has been the increased **globalization** of the world economy, which has led to a greater **interdependence** between countries of the world. We shall consider what globalization means, and what forms interdependence takes.

We then turn to the meaning of development and the challenge of development economics, focusing particularly on the ideas of Denis Goulet and Amartya Sen, who argue powerfully and persuasively that economic development must mean much more than just a rise in the average level of per capita income of a country. A concept of development is required that embraces all the economic and social objectives and values that countries strive for – not simply material progress but, in particular, the self-esteem of peoples and nations, and freedom.

We end the chapter by considering the perpetuation of underdevelopment and poverty; that is, the forces in the world economy that historically have produced and continue today to create divisions between rich and poor countries, and even to widen them. Differences in the structure of production between countries, unequal trade, the dependency of poor countries on rich countries, and the operation of international institutions can all interact to produce 'vicious circles' of poverty and relative stagnation for countries that get left behind in the development 'race'.

Development economics as a subject

The study of **development economics** as a separate subject in economics is a relatively new phenomenon. For the student today, it will be difficult to appreciate that as recently as 60 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 at least one course in economic development; there are scores of texts and thousands of case studies and articles on the subject.

The political and public concern with poverty and the poorer nations of the world is of equally recent origin. As far as poverty is concerned, Ravallion (2013), a former research director at the World Bank, has charted the evolution of attitudes to poverty over the past three centuries and concludes that the current worldwide consensus on raising people out of poverty is surprisingly recent. Up to the nineteenth century, the plight of the poor was largely blamed on themselves and, besides, poverty was socially useful because it provided plentiful cheap labour for industrial development. In the nineteenth century, some protection was provided for the poor in some Western countries, but little concerted action to reduce poverty itself. It was not until the second half of the twentieth century that a coherent theoretical framework emerged to show how high levels of poverty stifled effort, investment and growth, through lack of education, poor health and nutrition (see Chapter 7).

As far as poorer nations are concerned, the majority of the national and international bodies that exist today to promote development, such as national development banks, the World Bank and its affiliates, and agencies of the UN, were established after the Second World War in the 1940s and 1950s. Before the war, when most of today's poor countries were still colonies, there was much less focus on the economic and social problems of the developing (dependent) economies than there is today. Perhaps the facts were not so well known, or perhaps the attention of most people was focused on depression and unemployment in developed countries. Whatever the reason, the situation today is very different. The development of low-income and middle-income countries, meaning above all the eradication of acute poverty, is now regarded as one of the greatest social and economic challenges facing mankind, together with environmental pollution and climate change. As the Pearson Report (1969) remarked a generation 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 one another:

1. In the wake of the great depression of the 1930s, and in the aftermath of war, there was renewed interest among professional economists in the growth and development process and the theory and practice of planning.
2. The poor countries themselves have become increasingly aware of their own backwardness, which has led to a natural desire for more rapid economic progress.
3. The absolute numbers of poor people are considerably greater now than in the past, and greater awareness has struck a humanitarian chord in the world at large.

4. There has been a growing recognition by all concerned of the interdependence between countries in the world economy. 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 political and military ramifications and dangers of a world divided into rich and poor countries are even more serious now than they were in the past. The recognition of interdependence has also been heightened in recent years by the process of globalization, making all countries more vulnerable to shocks and financial crises, which spread through trade and capital movements.

Academic interest in development

As mentioned earlier, academic interest in the mechanics of growth and development is a *renewed* interest rather than an entirely 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 (albeit 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. There is perhaps an analogy here between the preoccupation of the classical economists at the time of Britain's Industrial Revolution in the eighteenth and nineteenth centuries and the concern of many economists today with the economics of development and world poverty. 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 (past and present) who immediately come to mind are Abhijit Banerjee, Kaushik Basu, Pranab Bardhan, Jagdish Bhagwati, Hollis Chenery, Paul Collier, Partha Dasgupta, Angus Deaton, Esther Duflo, Albert Hirschman, Harry Johnson, Nicholas Kaldor, Michal Kalecki, Paul Krugman, Simon Kuznets, Harvey Leibenstein, Arthur Lewis, James Mirrlees, Gunnar Myrdal, Raúl Prebisch, Dani Rodrik, Joan Robinson, Paul Rosenstein-Rodan, Walt Rostow, Jeffrey Sachs, Theodore Schultz, Amartya Sen, Hans Singer, Nicholas Stern, Joseph Stiglitz and Jan Tinbergen (our apologies to those we left out).

The question is often posed of 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 process, it is also a lengthy one, at least if 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 timescale of development, and how to speed up the process of development in a way that is consistent with freedom and democracy. Later in the present millennium, when primary poverty in most countries will, one hopes, 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 on the growth pains accompanying the transition from a primarily agrarian to an industrial or service economy.

As far as classical economic 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 in agriculture have not been uniformly depressive to the extent that Ricardo and Malthus supposed. Rising productivity and per capita incomes have accompanied 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 others that 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 200 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. Much 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. There are potential dynamic gains from trade, but the static efficiency gains based on primary production are weak, 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, as witnessed in recent years. 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 opposed 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, so that planning in developing countries was seen by many as one of the main means by which economic development could be accelerated. In many countries, the experience of planning has not been favourable, however, 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 failure 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, with the use of markets combined with different types of government involvement, for the maximization of social welfare. The state has a role to play in economic development (see Chapter 9).

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 practise, is to calculate the investment requirements necessary to achieve a target rate of growth of per capita income – commonly referred to as the 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. In Chapter 9, we shall consider the strengths and weaknesses of using this type of aggregate model in development planning, and the arguments for and against 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 of the subject were written (see, e.g., Hirschman, 1981; Little, 1982; Lal, 1983). We 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 monoeconomics (that is, the universality of neoclassical economics) on the one hand and neo-Marxism on the other, which 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 monoeconomics were the existence of a massive amount of surplus labour in agriculture in developing countries, and backwardness or late industrialization – the latter requiring 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 developed ones. The defence of monoeconomics 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 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 Southeast Asian countries, including China) 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 monoeconomics 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' and strategic protection may not be desirable and that the gains from globalization and interdependence could not be more equitably distributed across countries.

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, or 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 (1984), 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 Lewis (1984) 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.

That is what development economics is all about. **Development economics is the only branch of economics that attempts to understand and explain 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. What leads to compartmentalization is the wide diversity of subject areas, which then gives rise to the descriptive labels of monetary economics, labour economics, regional economics and so on, but all these subdisciplines employ a large measure of economic 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 toolkit 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) put 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 with 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 and protracted one. It took over 200 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) bemoaned the loss of historical perspective, which he attributed 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 present, 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 datasets that facilitate interesting and rigorous econometric work on the major determinants of intercountry growth performance. Paul Krugman (1992) 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 economists such 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 grow 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 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 empirical development economics

In recent years, theorizing in development economics has left centre-stage and given way to a much greater amount of empirical work made possible by the availability of large datasets at both the macro- and micro-level, and the development of user-friendly software for data handling. Whether this shift is desirable is debatable, and has been debated by the distinguished development economists Abhijit Banerjee, Pranab Bardhan, Kaushik Basu, Ravi Kanbur and Dilip Mookherjee in the prestigious Indian periodical, *Economic and Political Weekly* (Kanbur, 2005). One inherent danger of empirics is always ‘measurement without theory’, but today most empirical work in development economics is not of this type. It is mainly to test theoretical hypotheses about decision-making and economic behaviour at the micro-level, and about relationships between variables at the macro-level. In the former case, randomized control trials (RCTs) have become popular (see Banerjee and Duflo, 2011). In the latter case, the problem is one of deducing causation from correlations when most variables in the economic system are endogenous, that is, dependent on each other. One big advantage of RCTs is that they overcome the econometric problems associated with regression and correlation analysis relating to causation, endogeneity and identification. Some economists argue (e.g. Mookherjee, in Kanbur, 2005) that there is now too much empirics and not enough theory – that the balance has swung too far. The debate, however, is a sterile one because for understanding social science in general, and in the attack on poverty in particular, both theory and empirics are required. One without the other leaves economic policy-making in limbo. The way forward suggested by Mookherjee is a four-stage approach:

- Stage 1: empirical description of the relevant phenomenon.
- Stage 2: formulation of a relevant theory that might explain the phenomenon.
- Stage 3: testing and estimation of theory, maybe leading to a modification or replacement of previous theories.
- Stage 4: use of ‘best’ theory for purposes of prediction and policy evaluation.

This is the most sensible strategy for development economists to follow. As Kanbur (2005) concludes: ‘good sense will surely prevail and we will have both more theory and more good empirical work – a goldilocks solution for development economics’.

A 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 in the 1950s and 1960s and increased contact with developed nations, and has been strengthened from within by rising expectations as development has proceeded. Development is required 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 necessarily provide greater happiness but they widen individuals' choices, 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 first made during the Sixth Special Session of the United Nations General Assembly in 1974. The UN 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 developing countries to secure a 25% share of world manufacturing production by the year 2000 compared with the share then of 10%. The target was just met, thanks to rapid industrial growth in East Asia and the Pacific, and the share now stands at just over 30%. 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'. This goal has not been achieved. Since the breakdown of the Bretton Woods system in 1971/72, no formal international monetary order has been created.

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 healthcare should be basic priorities.
- Overall development aid should be increased for spending in areas of social policy.
- Developed countries should allocate 20% of their aid to basic social projects and, in return, developing countries should spend at least 20% of their budgets on social needs.
- The IMF and the World Bank should pay more attention to social factors when designing programmes.

Progress in these areas has been slow.

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

Then, prior to the new millennium in 2000, the countries of the world, through the UN and other bodies, agreed on a set of **Millennium Development Goals**, which set 8 goals and 18 development targets to be achieved by the year 2015 compared to the position in 1990 (see Table 1.1).

Table 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. *Target 10*: Halve, by 2015, the proportion of people without sustainable access to safe drinking water. *Target 11*: By 2020, to have achieved 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 HIPC (the Heavily Indebted Poor Country Initiative) 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 co-operation with developing countries, develop and implement strategies for decent and productive work for youth. *Target 17*: In co-operation with pharmaceutical companies, provide access to affordable essential drugs in developing countries. *Target 18*: In co-operation with the private sector, make available the benefits of new technologies, especially information and communications technologies.

Source: UNDP, 2002.

The most important commitment was to half the proportion of people living in absolute poverty, using $1 a day as the poverty line. This meant a reduction from a poverty rate of 41.6% in 1990 to 20.8% in 2015. This target was met globally, largely as a result of the dramatic fall in the numbers in poverty in China. Taking Africa and Asia as a whole, the target was not met.

Other goals met were halving the proportion of people without access to safe water, and reducing the incidence of malaria and tuberculosis. Important targets not met were: reducing by three-quarters the incidence of infant and maternal mortality; universal primary education; gender equality, and the HIV reversal target.

Sustainable Development Goals

In 2015, a new set of **Sustainable Development Goals (SDGs)** was set out at a special conference of the UN. There are 169 proposed targets grouped into 17 goals, which are listed in Table 1.2. The SDGs are more ambitious than the Millennium Development Goals, extending to such things as urbanization, infrastructure and climate change. Each of the goals addresses one or more aspects of poverty, and all are mutually reinforcing. For example, higher school enrolment, especially for girls, reduces poverty and mortality. Better basic healthcare will increase school enrolment and reduce poverty. Many poor people depend on the environment for their living, so a better environment will help poor people. However, the multiplicity of goals and targets have been criticized for being

Table 1.2 Sustainable Development Goals

Goal 1	End poverty in all its forms everywhere
Goal 2	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
Goal 3	Ensure healthy lives and promote well-being for all at all ages
Goal 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
Goal 5	Achieve gender equality and empower all women and girls
Goal 6	Ensure availability and sustainable management of water and sanitation for all
Goal 7	Ensure access to affordable, reliable, sustainable and modern energy for all
Goal 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
Goal 9	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
Goal 10	Reduce inequality within and among countries
Goal 11	Make cities and human settlements inclusive, safe, resilient and sustainable
Goal 12	Ensure sustainable consumption and production patterns
Goal 13	Take urgent action to combat climate change and its impacts
Goal 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
Goal 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
Goal 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
Goal 17	Strengthen the means of implementation and revitalize the global partnership for sustainable development

Source: United Nations, 2015.

too diffuse and lacking focus. It may be self-defeating to have so many 'priorities' if any of them are to be achieved. Clearly, the most important goals are the first four: ending poverty everywhere; ending hunger; ensuring healthy lives, and equal access to education for everyone.

Globalization and interdependence of the world economy

A third major factor responsible for the growing concern with poor nations 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 past 150 years. The first was from 1870 up 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 (1945) 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, while making countries more and more dependent on forces outside their control, as time, space and borders diminish in importance. Foremost among these forces are:

- The widening and freeing of trade. Over 30% 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 $3 trillion are exchanged on the world's currency markets every day.
- More foreign direct investment (FDI) by giant multinational corporations with greater 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, people-trafficking, prostitution and arms.
- The spread of information technology (IT), which can exacerbate contagion in financial markets.
- New institutions, such as the World Trade Organization (WTO), with authority over national governments, and new multilateral agreements on trade, services, intellectual property, 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, as occurred in the early 1980s and precipitated the debt crisis.

- Financial crises, such as the Asian crisis of 1997, and the banking crisis in the US and UK in 2007/8, which became contagious and spread like a disease, affecting not only the countries of origin but other parts of the world too.
- Commodity price rises (including the price of oil), which in 2008 more than doubled for several basic foods, such as maize and rice, leading to food riots in several poor countries.

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' that confer positive externalities (e.g. technology, information, healthcare) 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 assist developing countries in particular, 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, particularly, interdependence mean 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 the rising price of energy and the debt crisis led to mounting economic chaos. The 1980 Brandt Report, entitled *North–South: A Programme for Survival*, 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 poorer countries, 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 developing countries.
- Rising unemployment with inflation.

- International monetary disorder.
- Chronic balance of payments deficits and mounting debts in most developing countries.
- Protectionism, and tensions between countries competing for energy, food and raw materials.

Nothing much has changed since the 1980s. Poverty and hunger are still rife in the world. Tens of millions of people in poor countries lack productive employment. Civil wars in North Africa are leading to the mass migration of refugees and dispossessed people to Europe. There is international monetary disorder. There are chronic global imbalances of payments between countries, and international debt continues to grow. And there are growing tensions between countries 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 poor 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 world economy 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 (1980) called for:

- A long-term programme to meet the basic needs of poor countries, involving additional resource transfers of $4 billion a year ($15 billion at 2016 prices).
- 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 and China since the 1990s, for example) to deficit countries to remove balance of payments constraints on demand and remove the risk of a slide into international protectionism.

To this list, we could add new forms of global governance to cope with the consequences of globalization, which also represent the interests of those countries that suffer most from the effects of globalization: the poor and marginalized. This list of priorities is as relevant today as it ever was.

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 also 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 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 past four decades, developed countries have shown a genuine humanitarian concern over the plight of poor developing countries. 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. In the UK, bodies such as Drop the Debt and Make Poverty History have a strong voice. Aid from voluntary agencies to developing countries now amounts to over $10 billion annually. But whatever the motive for concern, the reality of world poverty and underdevelopment cannot be ignored. Furthermore, acute 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 textbook is 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 economic structure of developing countries geared to the production and export of primary products and low value-added manufactured goods.

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: development for what? Not so long ago, the concept of development 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, 2006), 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 acute poverty and, at the same time, to provide basic needs.
- **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.

These three 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 the famous economist J.K. Galbraith (1980) once called it.

Goulet's three core components of development are also related to Amartya Sen's vision of development (Sen, 1981, 1983, 1999), defined in terms of the expansion of people's **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 they face, and entitlements generate the capability to do certain things. According to Sen, the capabilities of a person reflect the alternative combinations of functionings the person can achieve, and from which they can choose one collection. The approach is based on a view of living as a combination of various 'beings and doings', with the quality of life to be assessed in terms of the capabilities to achieve valuable functionings.

Economic development should be thought of in terms of the expansion of entitlements and capabilities, which are not necessarily 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 healthcare, and what individuals can extract from the state.

In the final analysis, Sen views freedom 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, a 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 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).

These concepts and ideas of Goulet and Sen are part of what Qizilbash (1996) calls **ethical development**. Drawing on the work of Griffin (1986) in his book *Well-Being: Its Meaning, Measurement and Moral Importance*, Qizilbash (1996) suggests nine core values by which development should be defined:

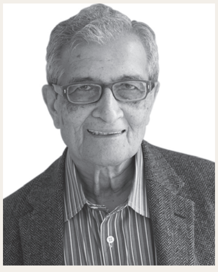
- minimum levels of health, nutrition, sanitation, shelter and security
- minimal capacities, including literacy and physical capacities

- self-respect and aspiration
- positive freedom or autonomy
- liberty
- enjoyment
- understanding or knowledge
- significant relations with others and some participation in social life
- accomplishment.

Thus, 'development occurs if and only if there is some overall expansion in human flourishing or the quality of human lives or human well-being consistent with the demands of social justice and freedom' (Qizilbash, 1996).

The new focus and stress on the ethical dimension of development, and the entitlements and capabilities of people (and ultimately freedom), is a natural switch in development thinking away from growth maximization to concern with the structure of production and consumption and distribution of income. As far as entitlements are concerned, Sen's dissent is that income is often a very inadequate measure, 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.

Amartya Sen



Born 1933, Santiniketan, West Bengal, India. Professor of Economics, Delhi University, London School of Economics, Oxford, Cambridge and Harvard Universities. Made important contributions to many branches of development economics, including choice of techniques, project appraisal, the measurement of welfare, and the analysis of famines. Foremost economist working on the interface between development and welfare economics. Sees development as 'freedom' – the title of one of his books. Awarded the Nobel Prize for Economics 1998.

In conclusion, 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 easily 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. For an illuminating case study, see Case example 1.1 on Costa Rica.

The challenge of development economics lies in the formulation of economic theory and the application of policy, in order to understand better and meet these core components of development. Clearly, the range of issues that development economics is concerned with is quite

Case example 1.1

Costa Rica: developing in the right way

According to the World Bank and the organization **Social Progress Initiative**, Costa Rica is, in many respects, a development success story. It is classified as an upper-middle income country with a per capita income of $13,000 in 2014, and has experienced steady economic expansion over the past 25 years or so. The country pursues a strategy of outward-oriented, export-led growth, and the attraction of foreign direct investment.

More importantly, it attempts to spread economic and social progress as widely as possible among its 5 million inhabitants. According to the Social Progress Index for 2015, calculated by the Social Progress Initiative based in Washington DC, Costa Rica is the country with most social progress relative to income. Among developing countries, only Chile and Uruguay rank higher, but both these countries have higher levels of per capita income. Costa Rica met six of the eight Millennium Development Goals in 2015. The Social Progress Index is based on such factors as: basic human needs; foundations of well-being; opportunity; nutrition and medical care; water and sanitation; shelter; personal safety; access to basic knowledge and information; personal rights, freedom and choice; tolerance and inclusiveness; and economic sustainability. The country scores highly on freedom of life choices, tolerance, lack of corruption and health, with a life expectancy of 80 years, which is higher than in the USA.

Elementary education has been compulsory since 1869; women in Costa Rica have more schooling than men, and the adult literacy rate is close to 100%. A welfare state was created in 1941. Democracy was established in 1948 and the army was abolished at the same time, saving millions of dollars on the military. Costa Rica's social expenditure on education and health is over 20% of GDP, much higher than the Latin American average. There is still some poverty, particularly among those of African descent, but attempts are being made to redress this inequality. The country takes seriously the public provision of leisure facilities and gives priority to the environment. **The Happy Planet Index**, constructed by the New Economics Foundation, ranks Costa Rica as the top country based on measures of subjective well-being, life expectancy and ecological footprint (care of the environment).

The country has moved close in recent years to the true meaning of development as defined by Goulet and Sen. Development is not just about a rise in the average level of per capita income; it is about the expansion of entitlements and capabilities, and ultimately personal freedom.

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 modified, if not 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 (2015) 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 pure 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 being 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 (see Chang, 2002; Reinert, 2007). Since the 1960s, there has been a second industrial revolution, which has propelled the so-called 'newly industrialized countries' of Southeast Asia and Latin America into industrialized states, and many others into semi-industrialized states. But many countries, particularly in Africa, 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 condition 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 release factors of production for other activities and provide the purchasing power over industrial goods (see Chapter 5).

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 human beings. Extremes of heat and humidity also reduce the quality of the soil and contribute to the low productivity of certain crops. It cannot be a 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 and growth 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 Southeast Asian countries in the latter half of the twentieth century.

External relations between countries also play a part in the process of poverty perpetuation, 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 10.) 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 exploited during the colonial era 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, and the 'increasing price' they have to pay for development inputs, relative to the price they receive for their exports, are, in the long run, 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.

Some of these issues will be discussed in Part 3 of this book, but first, Chapter 2 focuses attention on the magnitude of poverty in developing countries and the world distribution of income.

Summary

- Development economics is a challenging and exciting subdiscipline of economics, which addresses the fundamental issues of why some countries are poor and others rich, why some countries grow faster than others over long periods, and what is the best way to tackle poverty in poor countries.
- Interest in the progress of nations is not new. It was the fundamental preoccupation of all the great classical economists such as Adam Smith, Thomas Malthus, David Ricardo, John Stuart Mill and Karl Marx – but the subject matter of development economics has witnessed a revival since the Second World War.
- Revival of interest in development economics has been the result of several factors such as: increased awareness of world poverty; developing countries asking for a fairer deal from the functioning of the world economy; the call for a new international economic order; and the increased globalization and interdependence of the world economy. The Millennium Development Goals set out explicit targets for poverty reduction, education and health (among other things) to be achieved by 2015 and the new Sustainable Development Goals to be achieved by 2030 do the same.
- Economic development means more than a rise in the average level of income per head of a country. A definition of economic (and social) development must embrace a variety of goals and values that societies strive for, particularly self-esteem and freedom for people based on their entitlements and capabilities (to use the terminology of Amartya Sen).
- Economic development presents a major challenge to development economists and policy-makers. This is because there are structural forces at work within countries and in the world economy, which tend to perpetuate underdevelopment and poverty and cause countries to get caught in 'vicious circles' related to unequal trade between countries and the dependence of poor countries on the rich for aid and investment.

Chapter 1 **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 poorer countries' development?
4. Why was the status of the discipline of development economics called into question in the 1980s?
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 Sustainable 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 developed countries?
10. What is meant by 'globalization' and the mutual interdependence 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

Institute of Development Studies, University of Sussex www.ids.ac.uk
School of Development Studies, University of East Anglia www.uea.ac.uk/international-development

International organizations

World Bank www.worldbank.org
International Monetary Fund www.imf.org
United Nations Conference on Trade and Development (UNCTAD) www.unctad.org
United Nations Development Programme (UNDP) www.undp.org
Food and Agricultural Organization (FAO) www.fao.org
World Trade Organization (WTO) www.wto.org
World Health Organization (WHO) www.who.int

United Nations Industrial Development Organization (UNIDO) www.unido.org
International Labour Organization (ILO) www.ilo.org
African Development Bank www.afdb.org
Asian Development Bank www.adb.org
Inter-American Development Bank www.iadb.org
Center for Global Development (Washington) www.cgdev.org
NGO Global Network www.ngo.org
Heritage Foundation www.heritage.org
Sustainable Development Goals https://sustainabledevelopment.un.org/sdgs and www.un.org/sustainabledevelopment/sustainable-development-goals

Databases

Penn World Tables 8.1 http://knoema.com/PWT2015/penn-world-table-8-1
World Bank http://data.worldbank.org
World Bank, World Development Indicators http://data.worldbank.org/data-catalog/world-development-indicators
International Monetary Fund http://data.imf.org/
Gapminder www.gapminder.org/
World Health Organization, Global Health Observatory www.who.int/gho/en/
UN Comtrade http://comtrade.un.org/
UNIDO https://stat.unido.org/
UNU-WIDER www.wider.unu.edu/project/wiid-%E2%80%93-world-income-inequality-database

Globalization

Centre for Research on Globalization www.globalresearch.ca
Peterson Institute for International Economics http://piie.com
New Economics Foundation www.neweconomics.org