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# Economics of Development

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# ECONOMICS OF DEVELOPMENT

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For Elizabeth, Julie, Linda, and Anne

# PREFACE

This textbook is a product of close to seventy years of experience by its four authors in the field of development, including a quarter century of residence in developing countries. Our involvements have included teaching, research, and especially advisory work on development policy. At one time or another all four of us have taught Harvard's basic undergraduate course on the economics of development, and became convinced of the need for a text with broad and relatively uniform coverage of the wide range of topics that constitute the field of economic development. Our field work, mostly under the auspices of Harvard's Institute for International Development (HIID), persuaded us that a development text ought to have a substantial focus on policy issues, but that these should be imbedded in a historical and theoretical framework to provide perspective.

This book does not take a neutral attitude toward all of the issues pertaining to development. Not every section will begin with "On the one hand there are those who believe . . . while on the other hand there are those who hold the opposite." Where controversy exists we try to point it out. The co-authors of this book differ among ourselves over many questions of development policy, but we do share a common point of view in certain key areas.

First of all, this text makes extensive use of the theoretical tools of classical and neoclassical economics in the belief that these tools contribute substantially to our understanding of development problems and their solution. The text does not rely solely or even primarily on theory, however. For three decades and more development economists and economic historians have been building up an empirical record against which these theories can be tested, and this book draws heavily on many of these empirical studies. We try to give real country examples for virtually all the major points made in this book. In part these examples come from the individual country and cross-country comparative studies of others, but we also draw extensively on our own personal experiences working on development issues around the world. Among the four of us we have been fortunate enough to study and work over long periods of time in Bolivia, Chile,

China, Colombia, Ghana, Indonesia, Kenya, Korea, Malaysia, Peru, Sri Lanka, and Tanzania. At one time or another at least one from this group of nations has exemplified virtually all approaches to development now extant.

While this book draws extensively on the tools of classical and neoclassical economic theory, development involves major issues for which these economic theories do not provide answers, or at best provide only partial answers. In fact economic theory tends to take the *institutional context* (the existence of markets, of a banking system, of international trade, etc.) as given. But development is concerned with how one creates institutions that facilitate development in the first place. How, for example, does a nation acquire a government interested in and capable of promoting economic growth? Can efficiently functioning markets be created in countries that currently lack them, or should the state take over the functions normally left to the market elsewhere? Is a fully developed financial system a precondition for growth, or can a nation do without at least parts of such a system? Is land reform necessary for development, and if so, what kind of land reform? These institutional issues and many others like them are at the heart of the development process and will reappear in different guises in the chapters that follow.

This book is not for readers who are looking for a simple explanation of why some nations are still poor or of how poverty can be overcome. Library shelves are full of studies explaining how development will occur if only a nation will increase the amount it saves and invests, or intensify its efforts to export. For several decades in the mid-twentieth century industrialization through import substitution, the replacement of imports with home-produced goods, was considered by many as the shortest path to development. More recently labor-intensive techniques, income redistribution, and provision of basic human needs to the poor have gained popularity as keys to development. Many economists now counsel governments to depend substantially on unfettered markets to set prices and allocate resources. Another school of thought suggests that development is only possible if preceded by a revolution that eliminates existing elites and replaces the market with central planning. A different theme is that development will only be possible if there is a massive shift of resources, in the form of foreign aid and investment, from the richest nations to the poorest.

No single factor is responsible for underdevelopment, and no single policy or strategy can set in motion the complex process of economic development. A wide variety of explanations and solutions to the development problem make sense if placed in the proper context and make no sense at all outside that set of circumstances. Mobilization of saving is essential for accelerated growth in most cases, but sometimes may come second to a redistribution of income if extreme poverty threatens political stability or forestalls the mobilization of human resources. Import substitution has carried some countries quite far toward economic development, but export promotion has helped others when import substitution bogged down. Prices that are badly distorted from their free market values can stifle initiative



and hence growth, but removing those distortions leads to development only where other conditions are met as well. Moreover, some, but certainly not all, centrally planned economies have achieved sustained periods of development with prices that bear little relation to those determined by market forces. Finally, some nations have been ruled by leaders backed by interests hostile to development, or to any change; growth cannot occur in spite of such leadership.

### Organization

This book is divided into five parts. In Part I the main issues are what prevents development from taking place and what kinds of structural change occur once growth gets underway. Structural change, of course, does not just happen as a result of impersonal and uncontrolled forces. It is often the result of deliberate planning, and therefore the first part of this book also provides an introduction to the theory and practice of development planning.

Economic development is first and foremost a process involving people. People are the prime movers of development and the main beneficiaries. Part II therefore deals with how human resources are transformed in the process of economic development, and how that transformation contributes to the development process itself. There are chapters on population, labor, education, and health.

The other major physical input in the growth process is capital, and Part III is concerned with how capital is mobilized and allocated for development purposes. Where, for example, do the savings come from, and how are they transformed into investment? What kind of financial system is consistent with rapid capital accumulation? Will inflation enhance or hinder the process, and what role is played by foreign aid and investment?

Economic development, however, is more than a process of mobilizing inputs. One of the most fundamental issues facing a newly developing nation is the degree to which that nation should integrate its economy with the economies of the rest of the world. These international trade and interdependence strategies are the subject of Part IV.

Finally, issues such as technological change and various kinds of institutional reform often differ significantly between sectors of the economy. The problems of agriculture are different from those of industry, and natural resource development is different from either of the other two. In Part V, therefore, problems of economic development are approached from this sectoral point of view.

### Acknowledgments

It has taken us four years to translate our concerns and interest in development into a textbook, with a degree of success that must be judged by the reader. The effort spanned a sufficiently long period that the underlying data had to be changed more than once; we have brought the data up to 1980, or as close to that year as reliable sources permit.

In the course of this effort we have been helped in many different ways by a small army of colleagues. Paul Clark, David Singer, and Joseph Stern read the entire manuscript and offered pages of helpful advice that rivaled in length some of our own chapters. Ralph Beals, Richard Bird, Sebastian Edwards, James Duesenberry, Anne Krueger, Charles McLure, Malcolm McPherson, and Louis Wells read one or several chapters and helped transform these into more precise and readable essays. David Dapice, Arnold Harberger, and Sue Horton, along with Clark and Stern, were bold enough to use the draft manuscript in their classes and let us know how it performed under field conditions. We are indebted also to their students, and our own, who had to work through unfinished drafts to help improve the final product. Ricardo Godoy, who probably knows this text as well as any of us, went through the final manuscript with a dedication and competence beyond the ordinary, updating statistics, tracing references with painstaking thoroughness, and ensuring that the text reflected all these changes.

The manuscript has been through many drafts and the capable hands of many typists, including Daphne Crooks, Pauline Holson, Ann MacGowan, Emily Palmer, and Rita Reksoprodjo. Deborah Carroll then put the whole thing on her obsolete but technically appropriate word processor. Fred Bidgood completed the copyediting in what seemed like record time.

We have been encouraged in our work by many people, including the colleagues mentioned above. We are especially grateful to Lester Gordon, former director of HIID, who provided the initial impetus; and to Donald Lamm, president of W. W. Norton & Company, whose enthusiasm for the book and commitment to its authors sustained and prodded us to complete the manuscript in the face of seemingly overwhelming commitments to other projects.

We hope the book lives up to the expectations of all these people, and we thank them for helping us.

*Malcolm Gillis*  
*Dwight H. Perkins*  
*Michael Roemer*  
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**PART  
I**

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**THEORY  
AND  
PATTERNS**