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The Economics of the Developing Countries

5th edition

H. Myint

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Economics

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I

INTRODUCTION: THE POST-WAR APPROACH TO THE UNDERDEVELOPED COUNTRIES

There are two main driving forces behind the study of the underdeveloped countries. The first, which has grown rapidly under the pressure of post-war international tensions, is concerned with the need to do something urgently about the problem of poverty in these countries. The second, which has a longer academic tradition, is concerned with trying to understand the reasons for the great differences in economic development between the underdeveloped and the developed countries; it is concerned with the nature and causes of the 'Poverty of Nations'. Current ideas of the underdeveloped countries can best be understood against the background of these two approaches and their interaction upon each other.

The first line of approach focuses attention on the large difference in the per capita national income levels between the developed and the underdeveloped countries. This difference is regarded as the measure of the gap in the standards of living among the rich and the poor countries, highlighting the *prima facie* case for the rich to help the poor. Further, it is argued that the low level of per capita incomes of the underdeveloped countries is a major cause of their slow rate of growth and economic stagnation. These countries are said to be trapped in a 'vicious circle' of poverty, aggravated by growing population pressure on limited land: low incomes leading to a low level of saving and investment, leading to low productivity of labour and low incomes. It is (or used to be) maintained that the 'vicious circle' can be broken only by a 'crash' programme of economic development requiring a large inflow of international aid to supplement the inadequate domestic saving of the underdeveloped countries.

Now, one can readily accept the broad fact that the underdeveloped countries typically have a much lower level of material standard of living than the developed countries. But there is a considerable margin of error and ambiguity in trying to measure the gap in the standards of living from the different levels of per capita national incomes.

To begin with, the standard of living of a country depends, not on its per capita income as such, but on its per capita consumption. But in the poorer underdeveloped countries, the dividing line between 'consumption' and 'investment' is blurred. For instance, consumption expenditure which increases the nutrition and improves the health and productive efficiency of the people can claim to be regarded as 'investment' as much as the installation of a new machine. On the other hand, some underdeveloped countries attempt to pursue drastic methods of mobilizing savings and cutting down present consumption for the sake of accelerating future economic growth. In such a context, the distinction between per capita consumption and per capita income may be important. Next, the poverty of a country is more accurately reflected by the representative standard of living among the great mass of its population than by its per capita income. This representative income may be well below the average obtained by dividing the total national income of a country by its total population when income is unequally distributed. This consideration, ignored during the 1950s,[1] has come back to the forefront in recent times and will be considered later.

Then there are a number of well-known difficulties which arise in trying to compare the real income levels of different countries on the basis of the differences in money income levels. We may mention three of them.

First, we shall have to make allowances for the obvious but quantitatively important differences in the requirements for food, clothing, heating and shelter in different climates; most of the underdeveloped countries are in the tropics while most of the developed countries are in the temperate zone.

Second, we shall have to take into account the differences in the general stage of economic development, specifically, the degree of development of the exchange economy among the countries compared. A substantial part of the national product of the underdeveloped countries still takes the form of 'subsistence production' of food and other consumers' goods by small peasant farmers and their families

[1] cf. J. Viner, *International Trade and Economic Development*, The Clarendon Press, Oxford 1953, pp. 99–100.

for their own consumption. Although this subsistence output is not bought and sold, its imputed cash value has to be included in the national incomes of the underdeveloped countries to make them comparable with the national incomes of other countries where the exchange economy is more fully developed. There is a considerable margin of error both in estimating the physical quantities of subsistence output and in selecting appropriate accounting prices to value the different constituents of subsistence output. Further, the subsistence sector tends to shrink over time with the spread of exchange economy in the course of economic development. In this process, the goods which were previously freely obtainable through fishing, hunting or the gathering of forest produce would have to be purchased with money. Thus the growth of money incomes in a developing country is partly made up of the monetization of subsistence activity without a genuine increase in the physical quantity of goods and services available for consumption. Turning to the other side of the comparison, there is an important qualification to be introduced in interpreting the high levels of money incomes in the highly urbanized industrial countries. The real income level tends to be overestimated by the inclusion of a great number of 'cost' items, such as the cost of daily travel to work or the cost of reducing industrial pollution as items of income.

Third, international comparisons of incomes involve computing the national incomes of the individual countries in their own currencies and then converting the resultant figures into a common denominator, viz. the US dollar at the official exchange rates. An important source of error can arise from the choice of the exchange rate. Usually, the appropriateness of the exchange rate of a country is considered from the standpoint of maintaining its balance of payments equilibrium. Thus many underdeveloped countries, which have fixed their exchange rate at a level which does not adequately reflect their higher domestic rate of inflation relative to the general international rate of inflation, tend to get into balance of payments difficulties because of their 'overvalued' currency. Conversion of their national incomes at these 'overvalued' exchange rates will overestimate their real incomes relative to those of countries with a more moderate rate of inflation. But as against this, there is another factor which leads to an underestimation of the real incomes of the poorer underdeveloped countries relative to the advanced countries, even when the exchange rates are appropriate for the purpose of maintaining the balance of payments equilibrium. This arises from the existence of the 'domestic' goods and services which do not enter into international trade; or more precisely, from the different proportions in which the national output of the underdeveloped countries enter into international trade. In the advanced countries with a higher degree of internal economic development, the costs and prices of the non-traded 'domestic' goods are closely related to the higher wages and productivity of labour in the export industries. In contrast, the prices of the 'domestic' goods and services in the underdeveloped countries tend to reflect the general low levels of income and earnings of the local labour rather than the higher wages and productivity of labour in their export industries or their urban manufacturing industries producing import substitutes. For this reason, the 'domestic' goods and services of the underdeveloped countries are likely to be underestimated when valued at the official exchange rates. These exchange rates even when appropriate for the internationally traded goods do not really reflect the purchasing power of the currencies over the domestic goods and tend to exaggerate the differences in labour productivity in the 'domestic' goods sectors of the developed and the underdeveloped countries. Thus the poorer an underdeveloped country or the lower the ratio of its national output entering into international trade, the more its real income is likely to be underestimated relative to its nominal income at the official exchange rate. This source of underestimation is likely to be greatest for a country like India which has both a relatively low level of income and low ratio of international trade to total income because of its size.[1]

Apart from these qualifications, the per capita national income approach to the underdeveloped countries, which once dominated thinking has been put under an increasing strain from a more obvious cause: the per capita incomes of these countries as conventionally calculated have grown more rapidly than was ever dreamt of in the 1950s. During that period, the typical per capita income of the underdeveloped countries was considered to be about \$100 or less a year (in terms of the current purchasing power of the US dollar at that time) contrasted with the per capita income of \$1000 or more a year for the developed countries. The dividing line between the two groups of countries was then drawn at \$400 with some special cases such as an underdeveloped country like Argentina having an income above that level and an industrialized country like Japan having an

[1] cf. I. B. Kravis, A. W. Heston and R. Summers, 'Real GDP *per capita* for more than one hundred countries', *Economic Journal*, June 1978.

income a little below that level. By the 1960s, the average per capita income for the underdeveloped countries as a group was estimated to have risen to about \$200 a year, with a range of \$100 to \$500. The per capita income for the developed countries, including Japan, ranged between \$1500 and over \$4000 a year. Since then, all these figures have been continually revised upwards. Recently, the World Bank has abandoned the traditional practice of giving an overall average per capita income figure for the underdeveloped countries as a group. In its *World Development Report 1978*, the ninety-two developing countries are now reclassified into thirty-four 'Low Income Countries' and fifty-eight 'Middle Income Countries'. The 'Low Income Countries' have an average per capita income of \$150 (in terms of the 1976 US dollar) and the 'Middle Income Countries' have an average income of \$750. But the income range for the latter group is very wide, extending from \$250 to \$3000. The average per capita income for the developed 'Industrialized Countries' is \$6200 but there is an overlap in the incomes between the richer 'Middle Income Countries' such as Singapore and Venezuela with the poorer 'Industrialized Countries' such as South Africa and Ireland. The oil-rich Middle East countries have higher per capita incomes than the 'Industrialized Countries', with Kuwait having the world's highest per capita income of \$15,480 a year.[1]

Let us now turn from the level to the rate of growth of per capita incomes among the underdeveloped countries. The fact that their average per capita incomes appeared to have risen during the 1950–60 decade was properly treated with caution. But when the upward trend continued during the 1960–70 decade, it began to be accepted that the underdeveloped countries could grow. Now, looking back over a quarter of a century, it seems fair to say that the earlier view of the underdeveloped countries condemned to poverty and stagnation through the 'vicious circles' seems to be in need of a considerable revision. According to the World Bank Report, during the period 1950–75, per capita income of the underdeveloped countries as a group has increased by almost 3% a year, with the annual growth rates accelerating from 2% in the 1950s to 3·4% in the 1960s.

[1] *World Development Report 1978*, World Bank 1978, Table I: Basic Indicators. Communist China is said to have a per capita income of \$410 which would place her among the 'Middle Income Countries' among the underdeveloped countries. For earlier figures, see *Per Capita National Product of Fifty-five Countries: 1952–4*, United Nations Statistical Papers, Series E, no. 4, 1957; and *Trends in Developing Countries*, World Bank 1971, pt. 3.

This is an impressive achievement in the face of a rapid population growth at the rate of 2·5% a year during that period. Historically, the growth rates in per capita incomes attained by the underdeveloped countries compare very favourably with the recorded growth rates of the present-day developed countries during the period of industrialization—including a very rapidly growing country such as Japan.[1]

The inadequacy of the earlier view of the underdeveloped countries arises not only from its pessimistic assessment of their growth capacity but also from its attempt to make sweeping generalizations about them. The truth of the matter is that the underdeveloped countries are a highly diverse collection of countries which cannot be fitted into a simple theoretical scheme. The World Bank's attempt to divide them into two groups merely serves to highlight this diversity since there are considerable individual differences within each of the two groups.

Among the 'Low Income Countries', the slow growth of some countries, particularly in Africa, may arise from the fact that they are still at the earlier stages of transition from the traditional subsistence society to the exchange economy and do not as yet possess the necessary economic framework and social infra-structure to support rapid growth. Economic stagnation in other countries, whether in Africa, Asia or Latin America, is attributable to political instability and the lack of a reasonable degree of law and order, particularly in the rural districts. The slow growth of some of the South Asian countries such as Bangladesh or India may be plausibly explained in terms of population pressure aggravating poverty. But even here, one should bear in mind that population pressure on land cannot be considered without reference to agricultural techniques and government policies to encourage agricultural productivity. Where governments have pursued inappropriate policies of encouraging capital-intensive manufacturing industries at the expense of labour-intensive types of agriculture, they tend to aggravate the consequences of an unfavourable land-man ratio.

The 'Middle Income Countries' are equally diverse. They include countries such as Argentina which have long been established at a middle level of income and have nevertheless failed to achieve satisfactory growth due to political instability and inappropriate economic policies. They also include many countries which started at a much lower level of income and have risen to the middle income

[1] *World Development Report 1978*, p. 3.

level through rapid growth. Some of these countries have obtained rapid growth through the possession of oil and other mineral exports; others through the expansion of agricultural production and the diversification of primary exports; and a small but growing group of countries through the expansion of manufactured exports. Starting with labour-intensive manufacture such as textiles, this last group of countries has graduated to the exports of sophisticated manufactures and capital goods. In particular, the contrast between the slow growth of a country like Argentina and the rapid and indeed spectacular growth of countries like Taiwan and Korea emphasizes the inadequacy of the conventional approach to underdevelopment in terms of poverty, population pressure and 'vicious circles'. Thanks to her abundant land, Argentina has long enjoyed the highest per capita income level among Latin American countries, which in their turn, have a distinctly higher level of per capita incomes than the Asian and the African countries. Yet this favourable initial condition has failed to promote rapid growth in Argentina. On the other hand, Taiwan and Korea started in the 1950s with low per capita incomes typical of Asian countries and moreover have population densities on land as high or higher than India and Bangladesh. Yet Taiwan and Korea have transformed themselves into the 'success stories' of economic development through appropriate policies of raising agricultural productivity and expanding manufactured exports. Other rapidly growing countries such as Brazil, Mexico, Thailand, Malaysia and Ivory Coast also started out with low per capita incomes typical of their respective regions. If one could draw any generalizations about the fast-growing countries in spite of their diverse initial starting points, they all seem to have succeeded in expanding their agricultural production, both of food and non-food crops and their export production, both primary exports and manufactured exports.

The underlying theoretical presumption of the 'vicious circles' approach to the underdeveloped countries is that their low capacity to save is the most important constraint to their development. This view seemed plausible in the 1950s, when the underdeveloped countries were typically saving about 5% to 7% of their national income. Thus Professor Rostow specified the rise in the savings and investment ratio to no less than 10% of the national income as one of the conditions of the 'take-off' into sustained growth. Professor Lewis maintained that the conversion of a country from being a 5% saver to a 12% saver was 'the central problem in the theory of economic growth'.[1] However, these pronouncements were soon overtaken by the events. According to the World Bank *Report*, even the Low Income Countries were saving 11·6% of their GDP in 1960 and this ratio rose to 15·6% in 1975. The Middle Income Countries saved 17·8% of their GDP in 1960 and 22·1% in 1975. Further, there does not appear to be any close relationship between the rates of growth in the GDP of the two groups of countries and their average rates of domestic investment including the inflow of outside capital resources. During the period 1960–75, the average annual rate of growth in the GDP of the Middle Income Countries was 6%, twice as fast as the 3·1% growth rate for the Low Income Countries. This difference appears to be too large to be accounted for simply in terms of differences in investment ratios: 20·2% of the GDP for the Middle Income Countries as against 14·7% for the Low Income Countries in 1960; and 26·1% as against 19·1% respectively in 1975.[2] The rate of growth seems to depend not merely on the supply of savings, but on the capacity to invest the available resources productively.

It has been pointed out earlier that the per capita income of a country does not give an accurate measure of the representative standard of living of the mass of its population when the total national income is unequally distributed. Recently, there has been a considerable growth of interest in the problems of income distribution in the underdeveloped countries. The old pessimism concerning their economic growth is now succeeded by the new pessimism that economic growth by itself may not alleviate the problem of poverty in the underdeveloped countries and that the process of rapid growth may by-pass or even worsen the situation of the poorer section of the people in these countries. Some have suggested that the aims of economic development should be redefined so as to give priority to the goal of equalizing the distribution of incomes over that of increasing the total national output and income.

[1] W. W. Rostow, 'The take-off into self-sustained growth', *Economic Journal*, March 1956; W. A. Lewis, *Theory of Economic Growth*, London 1959, pp. 225–6.
[2] *World Development Report 1978*, p. 6, Text Table 8. This lack of association between the rates of growth and the rates of investment is borne out by other studies. For instance, Professor Reynolds, in his recent study of fifteen fast-growing developing countries (most of which are in the World Bank's Middle Income group) for the earlier period of 1950–65, found that the rate of gross investment for these countries was, if anything, slightly below the average rate for all the underdeveloped countries. cf. L. G. Reynolds, *Image and Reality in Economic Development*, New Haven, Conn. 1977, p. 263.

Now, it may be readily accepted that in spite of the rapid economic growth during the past decades, there still remains a considerable core of poverty in the underdeveloped countries. The 'growthmanship' of the 1950s and 1960s erred in putting too much emphasis on only one side of the complex problem of economic development. But this does not mean that we should make the opposite mistake of concentrating only on the problem of income distribution to the neglect of the problem of increasing productive efficiency and total output.

To begin with, it should be pointed out that the quality of statistics concerning income distribution in the underdeveloped countries is still rather poor. The primary sources of data are sample surveys in different countries, conducted for different purposes. The information is fragmentary and does not easily lend itself to international comparisons on a uniform basis. Further, in the context of the underdeveloped countries, we are interested not only in cross-section comparisons at a given point of time but also in the changes in income distribution over a period of time during which economic growth is taking place. Time series data on the income distribution in the underdeveloped countries are rudimentary.

Next, it is necessary to draw a distinction between two concepts of income distribution, reflecting two different approaches to 'the problem of poverty' in the underdeveloped countries. If we are primarily concerned with alleviating poverty in a material sense in order to reduce hunger and disease, we would be interested in income distribution in an absolute sense. In the context of an individual country, this is defined in terms of the absolute amount of income accruing to a given section of its population, say, the poorest 40%. At an international level, this approach focuses attention on the problem of raising the 'floor' in the material level of living available to the mass of the people in the underdeveloped countries. If, on the other hand, we are primarily concerned with the problem of easing internal or international tensions with the associated feeling of discontent and 'the revolution of rising expectations', then we would be interested in income distribution in a relative sense. For an individual country, this is defined in terms of the percentage share of the total income accruing to a given section of the population compared with other groups. At the international level, this approach focuses attention on 'the widening gap' between the per capita incomes of the developed and the underdeveloped countries, as distinct from the absolute level of material standards of living available to the latter.

The World Bank economists have approached the concept of income distribution in an absolute sense by drawing a 'poverty line' at a per income level, considered to be necessary to meet the basic needs of life and estimating the number of people in the underdeveloped countries living below the poverty line.[1] In an earlier study for the year 1969, they estimated that 370 million people would be living in absolute poverty if the poverty line was drawn at the per capita income of \$50, and the number would be raised to 578 million if the line was drawn at \$75. In their more recent study, they seem to have adopted a different basis for defining the poverty line: it is now drawn at the corrected international purchasing power of \$200 in 1970 prices (equivalent to \$279 in 1975 prices). On this basis, it is estimated there were some 770 million people in the underdeveloped countries living in absolute poverty in 1975. Using alternative assumptions about future rates of growth in population and income, the number of people living in absolute poverty is projected to decline to 600 million or to 260 million in the year 2000.

Whatever our views about the future trends, the past pattern of economic growth in the underdeveloped countries provides a useful perspective to the current estimates of their poverty. It will be remembered that during the 1950s, per capita incomes of \$50 to \$100 were thought to be the typical level of income for the *whole* of the population in the underdeveloped countries. Allowing for the changes in the purchasing power of money, that income level seems to be roughly comparable with the minimum income now adopted for the purpose of drawing the poverty line. This would suggest that although a large core of poverty still remains, considerable numbers of the population in the underdeveloped countries have benefited from economic growth during the past twenty-five years and that there has been some improvement in the representative 'floor' of living for the mass of the people. For instance, there has been a decline in infant mortality and a rise in life expectancy among the Low Income Countries during the period 1960–75.[2] It should also be pointed out that a very large proportion of the 770 million currently estimated living in absolute poverty are concentrated in a few South Asian countries such as India, Bangladesh and Indonesia

[1] cf. H. Chenery *et al.*, *Redistribution with Growth*, Oxford University Press 1974, Table 1.2, p. 12, and *World Development Report 1978*, Text Table 34, p. 33. For the definition of the current poverty line, see *Prospects for Developing Countries 1978-85*, World Bank, November 1977, pp. 7–8.

[2] *World Development Report 1978*, Text Table 10, p. 7.