Leading Issues in Economic Development

Fourth Edition

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FOURTH EDITION

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PREFACE TO THE FOURTH EDITION

The overriding objective of this fourth edition of *Leading Issues in Economic Development* remains the same as stated in the first edition—to present a new kind of course book that will bring some order to the diffuse subject of economic development without sacrificing a variety of viewpoints and different perspectives. The evolution of the subject confirms my belief that it can best be studied in a manner different from the usual approaches of either a textbook or a book of readings. Development practitioners must operate in an imperfect, second-best world, and development economists cannot yet claim that their subject constitutes a self-contained discipline. I believe that the student's most sensible introduction to economic development is through a study of several "leading issues" that are at present a major preoccupation of both development economists and development practitioners.

This new edition reflects the current development mood of stock-taking and reassessment. It focuses on an appraisal of development experience and the reinterpretation of development thought in order to highlight future policy options. After four decades of struggling against poverty, the international development community is asking what has gone right? What has gone wrong? And still we must be concerned with future efforts to lessen the pain of poverty suffered by two-thirds of mankind. But we must also put the future of the development movement in perspective by building on the lessons of development experience. From that experience, there should emerge fresh thinking on the leading issues in economic development.

I have chosen to concentrate on a relatively few issues that are now of central concern to development professionals. On each of these strategic issues, I have brought to bear a variety of materials that should be read together. To provide additional direction and cohesion, I have written a substantive commentary through a series of connecting text Notes. In some instances, I have introduced a Note to treat a topic more concisely than could be done through separate readings; in other instances, a Note is designed to cover a topic that is not yet adequately treated in the literature, or to tie one issue with another.

Even more than in earlier editions, I want to emphasize the importance of the interrelatedness of the readings on each issue—taken as a set—rather than any one particular reading. Each selection acquires added significance through its contextual position, and the materials are enhanced by their very combination. This is especially true for the interrelations among the various materials that deal with analysis, policy implications, and the lessons of development experience. The major focus is on the analytical core of the subject. At the same time, the analysis is made as policy-oriented as possible. And the materials can be readily supplemented by country cases and empirical studies.

The changes in this edition are extensive. I have introduced new chapters. I have also extensively modified all the earlier chapters, replacing many of the older selections with new selections that emphasize more current topics. I have tried to strengthen the entire book by eliminating the merely descriptive or wordy selections of previous editions and by including new selections that will deepen the student's understanding of fundamental economic principles and of empirical relationships. I have added more of my own Notes and revised the Notes contained in previous editions.

This edition also introduces Comments and Exhibits. The Comments are intended primarily to elaborate on selections, to raise questions, or to suggest additional readings on a topic that is not adequately covered in this book. The Exhibits present charts and tables that give more empirical content to the subject.

I wish to express my appreciation to the authors and publishers who have granted permission to use excerpts from articles, books, and other publications for which American or foreign copyrights exist. Specific acknowledgment is given with each selection. Some parts of the original versions of the selected materials have been (silently) omitted out of consideration for relevancy and to avoid repetition. In some cases, tables and diagrams have been renumbered; in other cases, footnotes have been omitted, while others have been renumbered.

As in previous editions, many of the revisions in this edition have been inspired by my students at Stanford University and by lecture audiences in developing countries. Their challenging questions and incisive observations have meant much to me. I hope this volume will prove of value to another generation of students concerned with the future of the developing world. This hope has sustained me through the laborious process of preparing this new edition.

My thanks are also due to Timothy Quey, Sridhar Moorthy, and Srikant Datar who relieved me of many library chores. And a very special acknowledgment is due Pat Sharp who has taken the roughest of copy and, with remarkable good humor and admirable efficiency, has guided the manuscript from handwritten scrawls through the word processor to the printer. Without the speedy imprint of her skills, this new edition would have been postponed indefinitely.

Finally, I wish to acknowledge the assistance I received while a Visiting Professor at the Economic Development Institute of the World Bank as well as the advice of Bruce F. Johnston, Walter P. Falcon, Derek Healey, and Paul P. Streeten—and the entire profession of development economists whose writings have contributed to this volume.

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ACRONYMS

ASEAN	Association of South East Asian Nations
C-20	Committee of Twenty
DAC	Development Advisory Committee of OECD
ECA	Economic Commission for Africa
ECLA	Economic Commission for Latin America
ECOSOC	Economic and Social Council
FAO	Food and Agriculture Organization
G-24	Group of Twenty-four
GAB	General Arrangements to Borrow
GATT	General Agreement on Tariffs and Trade
GNP	Gross national product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
ITO	International Trade Organization
LDCs	Less developed countries
MDCs	More developed countries
MTN	Multilateral trade negotiations
NICs	Newly industrializing countries
NIEO	New International Economic Order
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
SDRs	Special drawing rights
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
WFC	World Food Council
WFP	World Food Program
WHO	World Health Organization

CHAPTER I

The Development Record

We are concerned in this book with the future standard of living for 70 percent of the world's population—the poverty-ridden peoples in the less developed countries (LDCs) of Asia, Africa, and Latin America. Two centuries after the Industrial Revolution, most of the world is still poor. The need to accelerate the development of the poor countries remains, in the words of the recent President of the World Bank, Robert McNamara, "the central historical event of our times."

We examine the major analytical and policy issues raised by the challenges to accelerate economic growth rates, eradicate absolute poverty, reduce inequality, and create more productive employment opportunities. These challenges now require the international community to reassert the development priority and reshape development policies.

The World Bank emphasizes that the failure to achieve a minimum level of income above the "poverty line" has kept some 40 percent of the people in the LDCs in the condition of "absolute poverty"—a condition of life so degraded by disease, illiteracy, malnutrition, and squalor that it denies its victims the basic human necessities. The persistence of absolute poverty, despite respectable achievements in rates of growth in gross national product (GNP), is now of more concern than that of relative poverty, or a "widening gap" between the rich and poor countries. With the increase in the world's population, the number of people in absolute poverty below minimum standards of nutrition, health, shelter, and education has grown and is now of the order of 800 million.

A major theme of this book is the emphasis on discovering and promoting those positive forces that raise real income per head, improve employment opportunities, and achieve a wider distribution of the gains from development.

These forces of development are not, however, readily identifiable. After disappointments in the record of development, economists can no longer rely on simple causal relationships that emphasize development planning, capital accumulation, and foreign aid. The forces of development are too complex, subtle, and insufficiently known to yield to any simple formula.

One way of recognizing that a wide range of development forces must be identified is to realize at the outset that the development process encompasses more than the economic theory of production. Empirical studies of the sources of growth in output in a number of countries have demonstrated that much of the increase in aggregate production over a long period cannot be explained by an increase in only the standard physical inputs of the factors of production. A large part of the increase in total output remains to be attributed to some "unexplained residual factor" in the economy's aggregate production function. In historical studies of several presently advanced countries, the "residual factor"—the unisolated source of growth—is left to account for 50 percent or more of the increase in total output. This residual has been called a "measure of our ignorance" of the determinants that create a rise in productivity—the complex of little understood forces that cause output per unit of utilized resources to rise.[1]

A fundamental question is: What are the other sources of growth that can be identified in the catchall of the "residual," and introduced as inputs that are amenable to policy promotion? Another theme of this book, therefore, is the need to proceed beyond a narrow economic theory of production to a broader interpretation that requires attention to "efficiency" in the utilization of inputs as well as a wider understanding of an economy's "learning process."

An additional theme is that national development must now occur within the international context of coexisting rich and poor countries. Capital, technology, knowledge, values, and institutions are more readily transferable from rich to poor countries than ever before. There may, however, be drawbacks as well as advantages in being a latecomer to development, and the late-developing country is increasingly aware of the need for "appropriate" transfers. There is now a more imaginative search for means by which to raise the social benefit-cost ratio of these transfers to the developing countries.

At the same time, the greater interdependence between the more developed countries (MDCs) and the less developed countries (LDCs) gives the LDCs new negotiating strategies for designing trade, investment, and international monetary arrangements. The LDCs have assumed an enhanced role in shaping the emergence of a new international economic order to replace the old Bretton Woods system. The contentions of the United Nations Conference on Trade and Development (UNCTAD) and the criticisms of the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) must receive serious attention because the future of national development will be closely related to reforms in international trade and monetary arrangements—a new Bretton Woods II.

The time has also come for a reassessment of development planning and policymaking. Many have become disenchanted with centralized, detailed planning as it has been practiced in some LDCs. But even for the "lighter" type of framework planning, indicative planning, sectoral planning, the simpler monetary and fiscal policies, or only project evaluation—even for these less ambitious policies, the quality of policymaking must be raised. More efficient public-sector management is of the essence. The analysis of what policies are needed, the choice of policy instruments, and the methods of implementation must all be improved. Intimately related to improvement in policymaking is the role to be assigned to the market price system and decentralized decision making. The removal of price distortions and the use of the market as an instrument of policy are aspects of this theme of improving the quality of development policymaking.

To begin the pursuit of these several themes, this first chapter attempts to reach a clearer understanding of the meaning of economic development. The objectives of development are examined and certain misconceptions of development clarified in section I.A. The selections in section I.B. then consider different measurements of economic development and various

[1]Moses Abramovitz, "Resource and Output Trends in the United States Since 1970," *American Economic Review*, May 1956, pp. 11–14.

dimensions of poverty. Some of these selections reflect the shift from viewing poverty as inadequacy of means—for example, inadequate income—to viewing poverty as unsatisfactory results, such as low expectation of life and low levels of literacy. The recent emphasis on "basic human needs" is considered in selection I.B.3. Other selections explore the question of who benefits from development. Particular attention is given to the inequality of the "inverted-U hypothesis" (I.B.4) and the possible tradeoff between growth and equity (I.B.5).

Turning to an examination of country performance over the past three or four decades, section I.C. outlines some successful development strategies; summarizes some of the empirical evidence on growth, absolute poverty, and distribution (I.C.1); and evaluates the development performance of a number of countries—South Korea (I.C.2), Brazil (I.C.3), Sub-Saharan Africa (I.C.4), and China (I.C.5).

Our emphasis is on the disappointments in the development record: the low growth performance of the poorest countries, the unanticipated high rate of population growth, the weakness of the agricultural sector, the huge number in absolute poverty, and the pervasive underutilization of labor.

Considering these disappointments in the development record, the final Note (section I.D) in the chapter outlines the strategic policy issues that now confront the developing countries—issues to be analyzed in subsequent chapters. Unless these issues are resolved, the development effort will remain stalled, and the policy changes necessary to regain the development momentum and allow the LDCs to reach their potential will not be forthcoming. Such a loss will be all the more tragic when it is realized that forecasts for the year 2000 indicate that there will be four times as many people in the developing world than in the industrialized world. And with each year that the development effort stagnates, the severity of future problems only intensifies.

I.A. OBJECTIVES OF DEVELOPMENT—NOTE

Dissatisfaction with the results of the development effort over the past three decades has led to a refocusing of strategy to meet the future problems of development. The growth of GNP is no longer regarded as the main objective or index of development—but no single criterion can be readily substituted. To the dismay of the purist, but not to the surprise of the development practitioner, it is difficult to give one precise meaning to "economic development." Perhaps it is easier to say what "economic development" is *not*.

At the outset it should be recognized that economic development is not equivalent to the total development of a society: it is only a part—or one dimension—of general development. We usually focus on the nation-state as the unit of development, but "national development" is a term that encompasses, at a minimum, social and political development, as well as economic development, in the building of national identity. Depending on the orientation of one's discipline, it is also possible to consider other types of development—for example, legal or administrative. The interrelationships among these various types of development are extremely important. A major question implicit in our entire subject is how sociocultural and political development contribute to economic development and are, in turn, determined by it. It will be apparent that much more interdisciplinary study is needed to determine how economic and noneconomic forces interact.

It is also necessary to caution against equating economic development with either "economic independence" or "industrialization." As a result of their colonial history and newly acquired political independence, many poor countries have expressed discontent with their "dependence" on export markets and foreign capital. Such "dependence" is often interpreted as synonymous with "foreign domination" or "exploitation"—to be avoided now by import-substitution policies and restrictions on the inflow of private foreign capital. The emphasis on national independence through "inward-looking" policies and the advocacy of policies to avoid "foreign domination" become part of an ideology that might be called the "economics of discontent." But the "economics of discontent" should not be confused with the economics for development. National independence and the process of national consolidation may be called, as it is in India, "emotional integration";[1] but this is not to say that this noneconomic objective also contributes to economic development. "Inward-looking" policies are most likely to run counter to economic development, as is argued more fully in Chapter VIII.

Another aspect of the economics of discontent is the poor country's protest against being a primary-producing country. Industrialization tends to be viewed as a superior way of life; rich countries are believed to be rich because they are industrialized; and poor countries are believed to be poor because they are primary-producing. Whether an industrial society enjoys a superior way of life is, however, a noneconomic question. The relevant economic question for a poor country is whether agricultural development or industrial development is now the appropriate strategy for accelerating the country's economic development.

Economic development is not to be equated simply with industrialization for several reasons. First, the concentration of a large percentage of production in the primary sector is in itself not a cause of poverty: the cause is the low productivity in agriculture. A poor country's high ratio of agricultural population to total population is also more appropriately viewed as a consequence, rather than a cause, of poverty. Whenever the agricul-

[1]Gunnar Myrdal, *Asian Drama*, New York, 1968, pp. 53, 722–3.

tural population is poor, the nonagricultural population serving the agricultural population tends to be relatively small in size and also at a low standard of living. When the rural sector is prosperous, the nonrural sector tends to be large and also prosperous.[2]

Second, progress in industrialization is highly dependent on agricultural development. Without the necessary support of improvements in primary production, the policies of industrialization will be severely handicapped. In Chapter VII we examine the essential ways in which the rate of industrialization depends on surmounting the limitations of the agricultural bottleneck.

Third, economic development is much more than the simple acquisition of industries. It may be defined as nothing less than the "upward movement of the entire social system";[3] or it may be interpreted as the attainment of a number of "ideals of modernization," such as a rise in productivity, social and economic equalization, modern knowledge, improved institutions and attitudes, and a rationally coordinated system of policy measures that can remove the host of undesirable conditions in the social system that have perpetuated a state of underdevelopment.[4]

These views also imply that economic development involves something more than economic growth. Development is taken to mean growth plus change; there are essential qualitative dimensions in the development process that may be absent in the growth or expansion of an economy through a simple widening process. This qualitative difference is especially likely to appear in the improved performance of the factors of production and improved techniques of production—in our growing control over nature. It is also likely to appear in the development of institutions and a change in attitudes and values.

If we turn from what economic development is not, and attempt to consider its meaning more directly, we immediately encounter ambiguities because the ideal of economic development tends to be associated with different policy goals. The phenomena that one chooses to denote as "economic development" are very much a matter of what one values as the economy's policy goals. And any definition of development inevitably becomes a "persuasive definition," implying that development—as so defined—is a desirable objective.

Although requiring careful interpretation, perhaps the definition that would now gain widest approval is one that defines economic development as the *process* whereby the *real per capita income* of a country increases over a *long period* of time—subject to the *stipulations* that the number below an "absolute poverty line" does not increase, and that the distribution of income does not become more unequal. We emphasize *process* because this implies the operation of certain forces in an interconnected and causal fashion. In the following chapters we examine the process of economic development as a form of progressive action—a working-out of certain principal forces that reveal the inner structure or "logic" of an economy's development. To interpret development in terms of a process involving causal relationships should prove more meaningful than merely to identify development with a set of conditions or catalog of characteristics. If our interest in the development of a poor country arises from our desire to remove mass poverty, then we should also emphasize as the primary goal a rise in *per capita* real income rather than simply an increase in the economy's real national income, uncorrected for population change. For, if the criterion were only an increase in real national income, then it would be possible for aggregate output to rise without a per capita improvement in living standards. Population growth may surpass the

[2] For an elaboration of primary production as only an associative—rather than causative—characteristic of poverty, see S. Kuznets, *Economic Change*, New York, 1953, pp. 222–5; J. Viner, *International Trade and Economic Development*, Oxford, 1953, p. 50; G. M. Meier and R. E. Baldwin, *Economic Development*, New York, 1957, pp. 315–16.

[3] Myrdal, *Asian Drama*, p. 1869.

[4] C. E. Black, *The Dynamics of Modernization*, New York, 1966, pp. 55–60.