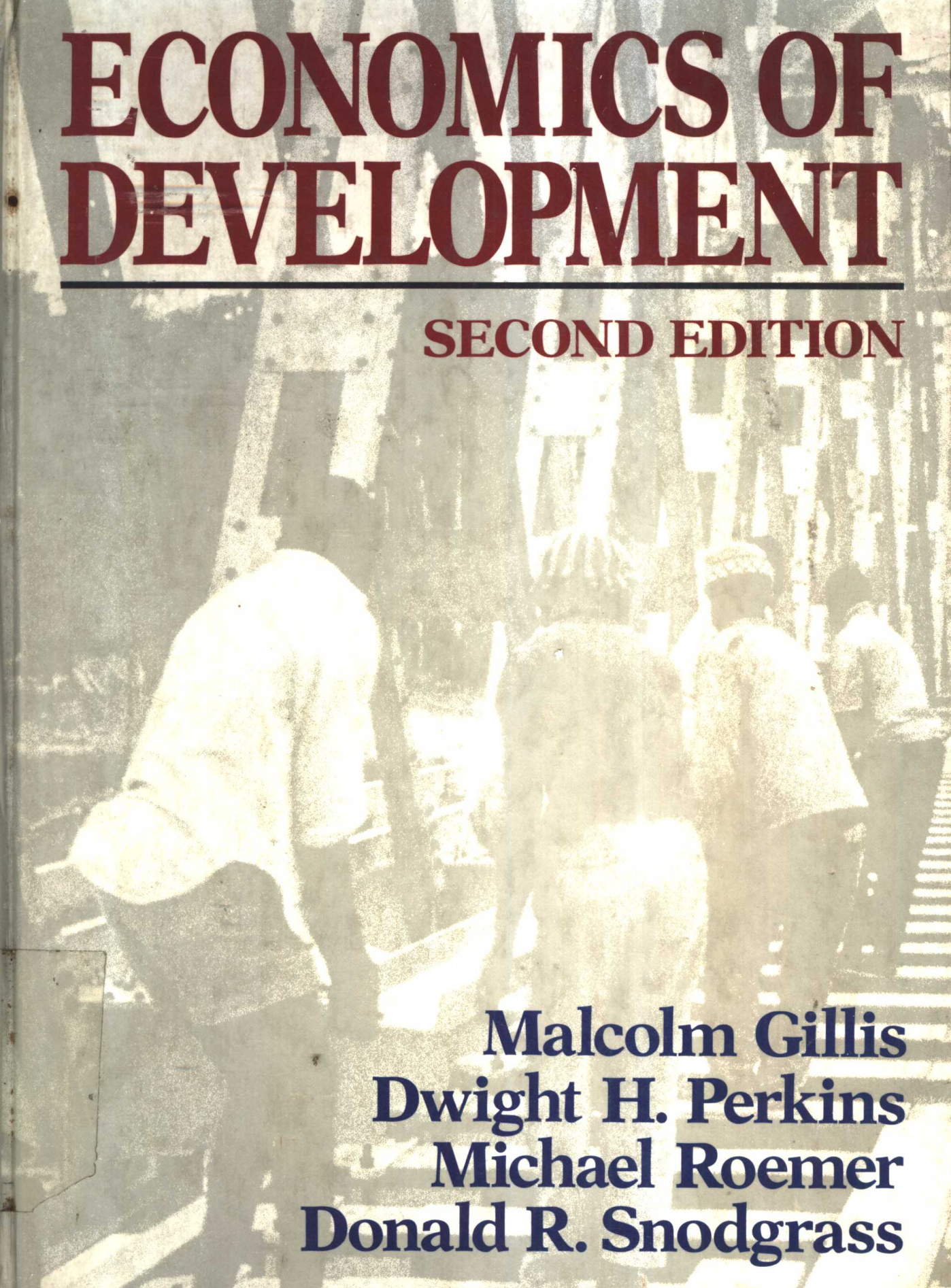


ECONOMICS OF DEVELOPMENT

SECOND EDITION



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Donald R. Snodgrass**

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Second Edition

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Preface

The consequences of economic development regularly make headlines. Japan, in ruins after World War II, becomes an economic superpower thirty years later and challenges the primacy of American industry. South Korea, widely regarded as a hopeless case after the devastation of the Korean War, bids in turn to challenge Japan for export markets. Malaysia, with less than half the average income of Chile as recently as 1963, takes only twenty years to equal Chile. Oil exporting countries, attempting to short-cut the normally slow accumulation of wealth by nations, manage to extract unprecedented revenues from consumers around the world, until the OPEC system weakens in the mid-1980s. Mexico, Brazil, Argentina, and other countries go deeply into debt to finance their development, then present world capital markets with a financial crisis when they are unable to repay. Public health makes such great strides after World War II that populations start growing dramatically. World population surpasses five billion, and three out of four live in developing countries. But during the 1980s overpopulation and drought conspire to create famine in Africa's Sahel; governments and rock stars respond with grain, money, and much fanfare.

Newspapers, and especially television, have bombarded our senses with these and other stories about development. The developing world no longer seems exotic or remote, and few doubt that the struggle for development will profoundly affect the way people live in the industrial countries. Enhanced awareness about development creates an opportunity for those of us who write textbooks, but also presents two challenges.

The first challenge is to keep up with the news. Development texts deal with contemporary history as well as tools of analysis and must be revised to reflect current events and thinking. The Second Edition of *Economics of Development* utilizes data published as recently as 1985 by the World Bank, United Nations, and other sources. It also pays more attention to matters of greatest current interest. Sections have been expanded or added on third-world debt, economic stabilization, the new protectionism, capital mobility,

population trends, and the destruction of tropical forests. The country examples have been updated where appropriate and new ones incorporated to illustrate important issues.

The second challenge is more difficult. News stories about third-world countries make development seem an exciting but ephemeral subject: it would appear necessary only to keep up with the latest events to capture the essence of the topic. But the reality is deeper. The challenge of a textbook is to distinguish between the merely evanescent and the truly enduring aspects of development. The forces underlying economic change are sometimes barely perceptible. But they can be powerful, radically altering a country's standard of living in two or three generations.

To meet this challenge, the second edition incorporates the distinguishing features of the first: (1) The 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. (2) The book draws heavily upon decades of empirical studies by economists and economic historians, studies that have uncovered and explained the structure of development, or at least narrowed our zones of ignorance. (3) *Economics of Development* deals explicitly with both the political and institutional framework in which economic development take place. (4) This edition presents many real-country examples to illustrate major points, drawing upon the authors' collective experience of more than ninety years of work on development issues. (5) The book recognizes the diversity of development experience reflected in these country examples, acknowledging that the lessons of theory and history can only be applied within certain institutional and national contexts. The ingredients causing economic failure in one set of circumstances might, in different circumstances or with a different recipe, lead to economic success.

ORGANIZATION

The second edition retains the organization of the first. Part I introduces the concept and measurement of development, some theories developed to explain it, and the body of data that has been amassed to recognize and define development when it takes place. Because planning has been closely associated with development, two chapters discuss the process and techniques of national planning.

People make development happen and people benefit from it. Part II deals with the contribution of human resources to development and with the transformation of human lives as a consequence of development. Chapters are included on population, labor, education, and health.

Capital, the other major physical input in the growth process, is the subject of Part III. It deals with saving and investment, fiscal policy, financial policy, and foreign aid and investment.

International trade binds developing countries to industrial countries and offers potentially effective strategies for accelerating the development process. Part IV explores these strategies.

In Part V, the lessons of earlier chapters are applied and extended to help understand development of the major sectors: agriculture, natural resources, and industry, with a final chapter on a pervasive institution of developing countries, the public enterprise.

SUPPLEMENTS

To help serve the needs of students and instructors, two supplements now accompany the text. A *Study Guide and Workbook* by Bruce Bolnick of Northeastern University provides review material, self-tests, and problem sets that will help students to grasp the major points more firmly. An *Instructor's Manual*, also by Bruce Bolnick, provides lecture and discussion topics along with answers to the problem sets in the workbook.

ACKNOWLEDGMENTS

In the course of writing two editions, we have accumulated many debts to generous colleagues who have read chapters, reviewed the entire book, tested the manuscript in their classes, or otherwise encouraged us: Paul Albanese (Middlebury College), Ralph Beals (Amherst College), Richard Bird (University of Toronto), Bruce Bolnick (Northeastern University), Paul Clark (Williams College), David Dapice (Tufts University), James Duesenberry (Harvard University), Sebastian Edwards (University of Southern California), Alfred J. Field (University of North Carolina), Lester Gordon (Harvard University), Arnold Harberger (University of Chicago), Sue Horton (University of Toronto), Alan Kelley (Duke University), Anne Krueger (Duke University), Charles McLure (Stanford University), Malcolm McPherson (Harvard University), Caroline Schwartz (Emory University), David Singer (University of Connecticut), Joseph Stern (Harvard University), and Louis Wells (Harvard University). Though we cannot list their names, we would also like to thank the nearly fifty teachers who responded to a detailed questionnaire about the First Edition.

Ricardo Godoy's dedicated work on the data for the First Edition was carried forward by Kit Crowe, who updated the tables and coordinated textual revisions with admirable energy and efficiency. Marty Ferry produced and revised the entire manuscript. JoAnne Giovino, Gretchen O'Connor, and Andrea Yelle gave support at various stages of revision. At W. W. Norton, Donald Lamm continued to encourage us, while Drake McFeely and Patty Peltekos transformed the manuscript into the book you are reading now.

We have worked toward a book that meets the expectations of all these people, and we thank them for helping us.

Durham
Cambridge
Cambridge
Cambridge

M.G.
 D.H.P.
 M.R.
 D.R.S.

January 1987

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PART 1

**THEORY
AND
PATTERNS**

Introduction: Worlds Apart

The people around the village of Jalab, in Senegal, West Africa, and many rural towns of Georgia in the United States depend upon the same essential crop: peanuts.¹ West Africa and the United States are two of the biggest commercial producers of peanuts. The story of their cultivation and marketing is the story of two very different worlds.

Slave ships carried peanuts to the American South because colonists needed a high-protein, high-caloric staple to feed their captives. Growing conditions proved ideal, especially in Georgia, where cultivation thrived and where today nearly half the American crop is harvested. Peanuts are the eleventh most valuable crop grown in the United States, worth half a billion dollars a year.

John Johnston, a thirty-four-year-old Georgia peanut farmer, cultivates 540 acres of peanuts and another 650 acres of corn. His ground is prepared for planting by tractor. Government-sponsored research has discovered improved combinations of seed and fertilizer, and the extension service ensures that farmers know how to use them. Pesticides are sprayed on Johnston's crop from airplanes. Combine harvesters pick the ripe plant and separate the peanuts for drying. Johnston sells his crop to a broker in nearby Blakely, where the peanuts are stored in modern warehouses. The broker sells them to processors through larger brokers in Atlanta, New York, or Chi-

1. This narrative is adapted from a television film by Otto C. Honegger, *The Nguba Connection*, jointly produced by WGBH Boston, Swiss TV Zurich and Swedish TV (SK2). We are grateful for permission to use this material. Names have been fictionalized.

cago. The price received by Johnston is maintained above the world-market price by a U.S. government support program that restricts imports, limits domestic acreage, and protects the farmer from price fluctuations. Research, mechanization, efficient marketing, government price supports, and hard work enable Johnston to net as much as \$100,000 from his peanuts in a good year. At this income, the Johnston family lives in comfort, enjoying the wide variety of goods—basics and luxuries—available to affluent Americans.

In Senegal, Cherno Sar grows peanuts on his small farm near Jalab. Like Johnston, Sar inherited his land, which is the sole support for his family of five, plus three relatives. Like Johnston, Sar cultivates relatively good land for peanuts and he has begun to mechanize what was until recently a hand-picked harvest. But his plows are not as productive as Johnston's combines, while fertilizers and insecticides are either unavailable or too expensive. Sar's yields are about a fifth of Johnston's. And his output must be sold to a government corporation that pays the farmer well below the world-market price in order to extract tax revenue for the government. Storage facilities are rudimentary and much of the harvested crop may be lost to blight, insects, or bad weather. The small size of their farm, poor yields, low prices, and storage losses keep the Sar family very poor. Eight people must live on only \$400 of cash income in a good year, much less than John Johnston's field workers, who earn \$100 a week when they work and are extremely poor by American standards. Even though the Sars grow much of their own food, their diet is inadequate, consisting mostly of millet made into a gruel. Jalab has no electricity, no school, no clinic, no shops. Cherno's wife draws water from a village well a few hundred yards from their hut, much closer than for most farm families in Senegal. For every hundred children born in his village, twenty will probably never see their first birthday.

Not all Senegalese are as poor as Cherno Sar. In Dakar, the modern capital, officials of the government peanut marketing corporation work in air-conditioned offices, own cars, and live in substantial houses, enjoying some of the same comforts as the Johnstons in Georgia. Their children attend the best schools in the country and, if necessary, can be treated in a nearby modern hospital. Of course these officials are part of a minority group in Senegal, a group favored by birth, education, urban benefits, and income over the vast majority of poor, small farmers. The peanuts the government buys are mostly exported. The resulting government revenues help pay the salaries of government workers, who are much better off than Cherno Sar; the foreign exchange helps to pay for imports that are consumed largely by people in the cities.

In each country the political process reinforces disparities. John Johnston is represented in Washington by a congressman who is responsive to his needs. Congressmen representing farm states remain powerful enough, even in a predominantly urban country, to perpetuate the government's price supports, agricultural research, and extension system that have been so beneficial to farmers like John Johnston. Cherno Sar has little or no political influence. Although farm families like his make up most of Senegal's population, it is the minority urban dwellers who command most of the government's attention and resources. Sar is virtually helpless to influence the price

the groundnut marketing corporation pays for his crop or what services the government provides him and his family.

Nor is there any international mechanism to reduce the vast disparities between people like the Johnstons who live in North America, Europe, and Japan, and the much greater numbers of people like the Sars who live in Africa, Asia, and Latin America. Although national fiscal policy can transfer income from rich to poor within a country, no international fiscal mechanism exists. Foreign aid has been conceived as a method of transfer from rich to poor nations, but it is voluntary and grossly inadequate for the task. Discussions have taken place about international price supports, such as those that exist within many countries, that would raise the incomes poor countries earn from their commodity exports. But differing national interests make agreement on such schemes unlikely. U.S. restriction of peanut imports, which discriminate against the Sars and help the Johnstons, are only one of hundreds of trade restrictions that slow international development.

Why do disparities like these exist? Why are Sengalese farmers—and three billion like them in other countries—so poor while Americans and Europeans are rich? What could be done about it, by Sengalese or Americans? And what is *likely* to happen? These questions, and many others suggested by them, are the subject of this book.

THE THIRD WORLD

The two worlds of the peanut farmer are sharply defined and widely separated by geography, income, standard of living, and economic, social, and political structure. They make it easy to see the differences between “development” and “underdevelopment.” But the world is complex, and such simplified, dichotomous examples cannot do justice to the many-dimensional continuum that explains economic development. The bulk of this text is devoted to exploring that continuum, and no single chapter can do the work of an entire book. This chapter will orient you within the variegated world of developed and underdeveloped countries. Before attempting that, however, we need to sort out some terms.

Terminology: Rich and Poor Countries

The countries with which this book is concerned have been referred to by many different terms. All these terms are intended to contrast their state or rate of change with those of the more modern, advanced, developed countries, so that terms tend to be found in pairs. The starkest distinction is between **backward** and **advanced** economies, or between **traditional** and **modern** ones. The “backward” economy is traditional in its economic relationships, in ways that will be described in the next chapter. However precisely and neutrally the term can be defined, it retains perjorative connotations, a touch of condescension, and is therefore not much used today. In any case, the implication of stagnation is inappropriate for in most countries economic and social relationships are changing in important ways.

The more popular classification terms implicitly put all countries on a continuum based on their **degree of development**. Thus we speak of the distinctions between **developed and underdeveloped** countries, **more and less developed** ones, or, to recognize continuing change, **developed and developing** countries. The degree of optimism implicit in “developing countries” and the handy acronym, LDCs, for “less developed countries,” make these the two most widely used terms.² Developed countries are also frequently called the **industrial countries**, in recognition of the close association between development and industrialization.

A dichotomy based simply on income levels, the **poor** versus the **rich countries**, has been refined by the World Bank³ and combined with a second distinction, based on type of economic organization, to yield a five-part classification that is useful for some analytical purposes. The developing countries are divided by income into **low income** (less than \$400 per capita in 1983) and **middle income** (between \$400 and about \$6,900 in 1983). The third category of developing countries consists of five petroleum exporters (Oman, Libya, Saudi Arabia, Kuwait, and the United Arab Emirates), whose incomes ranged from \$6,300 to \$23,000 per capita in 1983, but whose economies are more traditional than industrialized; the World Bank calls this anomalous group the “capital-surplus oil exporters.” The **industrial economies** are divided into **market** (Western capitalist) and **nonmarket** (Eastern Communist) economies.

The term now in greatest vogue, especially in international forums, is the **third world**. Perhaps the best way to define it is by elimination. Take the industrialized market economies of Western Europe, North America, and the Pacific (the “first” world), and the industrialized but centrally planned economies of Eastern Europe (the “second” world); the rest of the countries constitute the third world. All third-world countries are developing countries and these include all of Latin America and the Caribbean, Africa, the Middle East, and all Asia except Japan. The geographic configuration of this group has led to a parallel distinction—**north** (first and second worlds) versus **south**—that is also in current vogue. But the south or third world encompasses a wide variety of nations. The obvious differences between the wealthy (if structurally underdeveloped) oil exporters and the very low-income, poorly endowed countries have led some to add fourth and fifth worlds to the classification. Political motivations create further exceptions: South Africa and Israel are usually not considered part of the third world; nor are Spain and Portugal, former colonial powers, although in many respects they are less developed countries.

2. Recently, the initials “LDC” have been used, especially by the United Nations, to designate the “least developed” countries, those with incomes below \$100 per capita (among other characteristics). In this book “LDC” is used to mean “less developed country (or countries).”

3. The World Bank, formally titled the International Bank for Reconstruction and Development (IBRD), is owned by the governments of its 148 member countries. The Bank borrows funds on private capital markets in the developed countries and lends to the developing countries. Its affiliate, the International Development Association (IDA), receives contributions from the governments of developed countries and lends to the low-income countries at concessional terms (very low interest rates and long repayment periods). The World Bank and IDA are important and influential development agencies. See Chapter 14 for a more complete discussion.