FOURTH EDITION

THE ECONOMICS OF DEVELOPMENT

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The Economics of Development

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Preface

I have spent much of my academic career studying economic development. As a consultant, I have worked with the governments of nations so different that they might be selected to test the hypotheses of economic development. I examined the very low income, moderately populated Burma; El Salvador, before its present civil war, with its extremely high population density; innovational surging Japan; and Saudi Arabia, with its unlimited supplies of capital (to adapt Lewis's phrase). Within the rectangle formed by those countries, I have also done academic research in Colombia, Argentina, and Brazil.

This book is the fourth edition of a text first published in 1968. Yet in essence it is a new book. It reflects the changes in the discipline and in my own outlook. Economic development is not a static field where accepted doctrine can be taught year after year. For example, (1) we have known for a long time that nominal calculations of per capita income levels for the lowest income countries were grossly in error. The International Comparison Project has given us measurement of the true scale of differences along the entire range of incomes from low to high. (2) Field research has shown that there is no significant amount of labor with zero marginal productivity in even the more densely populated lower income countries. China and India may be the limiting cases, in which the marginal productivity of labor (MPL) most closely approaches zero, but there is reason to question the pertinence of the hypothesis to even these countries. (3) We now know that migrants from rural to urban areas typically find employment quickly. We have learned that, until the slowing of economic growth in the industrial countries in the late 1970s, and hence in those countries' demand for industrial and consumer materials, open unemployment in the lower income countries was not high except in many sub-Sahara African countries. There is certainly unemployment in many less developed countries (LDCs), but it is not the "widespread and rising" unemployment that has been assumed by some development theories. Unemployment in Latin America was moderate until the late 1970s and was low in Asia. As is noted in Chapter 8, the high recorded figures in some cities turn out to be illusory. (4) Most economic theorizing has dismissed the idea that technical advance may cause a net increase in unemployment in an economy as fallacious. However, it can now be shown that labor-augmenting (labor-saving) technical advance does cause a net increase in unemployment, and that the endogenous and exogenous sources of increase in aggregate demand that often largely or wholly offset "technological disemployment" must be explained to understand the growth process.

These are examples, not a complete list, of facts that recent research is requiring us to recognize. These facts in combination force us to realize that even though the productivity of the lower income countries is low *their economies function much more efficiently than had been supposed by condescending Westerners, including students of development*. This is true for all but the small group of countries known as the "least developed countries." Such a recognition forces us to reject or recast a number of older theories relating to growth, and to search more deeply for the causes of low income and of differences in growth rates. Why have the large majority of less developed countries not developed as rapidly as they would have liked to? This is one, though only one, of the topics with which a text in the economics of development must deal.

Note to instructors and students

This book is quite different from previous editions. I have prepared a basically new book for two reasons:

1. My consulting experience and academic research which I described above have led to a broader understanding of the issues.
2. Teaching successive classes of students at the Massachusetts Institute of Technology and teaching briefly as a guest lecturer at Florida International University, I found the book was not ideal from an instructional standpoint. As a result, the flow of presentation has been restructured greatly, much new empirical material and some added theoretical analysis has been added, and some material has been deleted. I believe that the reorganization makes the book much more teachable.

The book is divided into five parts. Part I presents basic introductory materials; income levels, both nominal and correctly measured, and growth rates; theories of barriers to growth, significant dissimilarities among the less developed countries, the nature of the economies of the low income countries, the effects of poverty in those and other LDCs, and the nature of the growth process.

Part II deals comprehensively with growth and reform in agriculture and with the industrialization process, including the question of import substitution versus export promotion. Part III discusses the theory and the operation in LDCs of inputs into growth (that is, rise in per capita income): labor itself, capital formation, education, entrepreneurship, and government (spender, taxer, producer, regulator, and planner). The possible causes, virtues, and harms of inflation and the nature of formal planning are discussed. The relationship of governmental institutions to growth in Japan and China are analyzed in a separate chapter.

Part IV deals with a set of topics related to the distribution of income: the factors that may or may not increase aggregate demand sufficiently to maintain full employment as aggregate productive capacity rises through population increase and technical advance, the so-called population problem, varied effects of economic growth on income distribution, and the efficacy of governmental policies to help the poor to meet basic needs.

Part V discusses international aspects of economic development: first, international trade (including customs unions, cartels, "South-South" trade, and proposals for stabilization of prices and of the income from trade), then capital inflow into LDCs (the general theory of capital inflow, direct investment, economic aid, and loans by private financial institutions). Attention is given to the effects and implications for the LDCs of the burst of bank lending during the 1970s and the financial crises of 1981–83. The book ends with a sketch of the vision of a new international economic order and actual prospects for the remainder of this century.

The chapter order as it appears in the text is one logical order of presentation. Some instructors may wish to consider also either of two alternative orders: assignment of Chapter 8 on the employment and productivity of labor in the economically less developed countries and Chapter 17 on income distribution, or only Chapter 17, following Chapter 4. The first segment of the course will then include presentation of the facts and problems related to income distribution and of some pertinent theories in addition to the basic introductory facts concerning income levels and growth rates.

The questions of whether world growth must end for lack of minerals or for lack of food are discussed briefly in the chapters on industrialization and on population growth.

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Introduction

Part I is introductory, but it is more than introductory. It sets forth the basis for the study of the process and theory of growth. Chapter 1 describes the "nominal" income levels and the rates of growth of all of the world's countries with populations of 1 million or more. Chapter 2 states and criticizes theories that certain barriers prevent the growth of the less developed countries. Chapter 3 notes the many ways affecting growth in which the countries called less developed differ from the more developed countries and from each other. Lastly, Chapter 4 describes the typical low-income countries and a group of countries least likely to grow, sets forth the problem of poverty, and outlines the growth process.

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Some Introductory Facts

On the average, China, India, and the peoples of Africa have lower incomes than the average income of other Asian countries, the peoples of Asia lower incomes than the peoples of Latin America, the Latin Americans lower than the peoples of southern and eastern Europe, these lower than the peoples of western Europe, northern America, New Zealand, Australia, and Japan, and these in turn lower than a few high-income petroleum exporters of the Middle East. These statements are true of averages only; the ranges of individual-country incomes overlap, but the statements about averages give a true impression of the geographical distribution of income in the world.

Within each country, family incomes differ greatly. The incomes of the lowest-income families of Africa and Asia are very low indeed. No groups of Americans have low incomes remotely comparable except for the thousands of homeless derelicts who subsist—live is hardly the word—on the streets and in the alleys of our larger cities with no income whatever except for the food that is given to them in soup kitchens and the sleeping space in large, barnlike buildings that city governments or charitable organizations provide.

1.1 The Meaning of Economic Development

The lowest income group in a low-income country is the peasants. A peasant may farm a few acres of land, planting seeds by hand, cultivating with a wooden-toothed harrow drawn by a pair of bullocks, threshing by walking the bullocks round and round over the grain to loosen the seeds from the leads, then picking away the straw and letting the grain fall from a