LEADING ISSUES IN ECONOMIC DEVELOPMENT

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THIRD EDITION

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PREFACE TO THE THIRD EDITION

Development economists must operate in an imperfect second-best world, away from the simplified premises of neoclassical economics. Their subject matter is therefore not yet a coherent or self-contained discipline. Denied recourse to a set of general principles, perhaps the student's most sensible introduction to economic development is through a study of a number of "leading issues" that are at the time a major preoccupation of the development economist and development practitioner.

As reflected in this new edition, the "leading issues" now coalesce in a central theme: policies which are designed to eradicate poverty, reduce inequality, and deal with problems of employment. This does not mean that analysis of the overall process of development is any the less important, but it does require more attention to the connections between these particular objectives and the more aggregative analysis. This theme also calls for forward-looking analysis to determine the position of the developing countries under new international trade and monetary regimes. But in evaluating possible alternatives, the discussion must also give due attention to what has gone wrong in the past, and to theoretical analyses that might contribute to improved policy formulation.

This new edition, therefore, incorporates extensive changes. I have added new chapters. I have also extensively modified all the earlier chapters, replacing most of the earlier selections with new selections that better illuminate the central theme of this edition. New selections are also included to raise the level of theoretical analysis and provide more empirical relationships. I have also taken the opportunity to add more of my own Notes and to revise the Notes contained in previous editions.

My overriding objective remains the same as stated in the first edition—to present a new kind of course book for the study of economic development. 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. I have therefore chosen to concentrate on relatively few issues that are now of central concern to development economists. On each of these strategic issues, I have then brought to bear a variety of materials that should be looked at simultaneously. And to provide additional direction and cohesion, I have written a substantive commentary through a series of connecting text Notes. These Notes integrate or supplement the other selections. In some instances, I have introduced a Note to treat a topic more expeditiously 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, it should now be emphasized that greater importance is to be attached to the interrelatedness of the readings on each issue—*taken as a set*—than to any one particular reading. Each selection should acquire added significance through its contextual position, and the materials should be enhanced by their very combination. This is especially true for the interrelations among the various materials that deal with analysis, policy implications, and the results of development programs.

The interrelatedness among the chapters is also more pronounced now than in earlier editions. All the issues bear on the central theme of poverty, inequality, unemployment. The dominance of this theme gives more of a progressively interrelated argument to the subject and makes this edition more cohesive.

In restraining myself from proceeding in too many directions, I have had to exclude a considerable amount of subject matter that should eventually become part of the development economist's education. I have not ventured far into the formal methodology of development programming or planning techniques. Any excursion into the design of numerical, dynamic, multisector development planning models would rapidly become another course in its own right. Similarly, the range of country studies is now so extensive that the use of country examples can serve only to illustrate a more general problem or principle. Full-scale country studies have to be sought elsewhere. Nor is there as much crossing of the boundaries of economics into the noneconomic issues of development as the political scientist or sociologist would desire. I can only plead that an introductory book in development economics cannot offer everything for everyone. I hope that the introduction is sufficiently stimulating, and enough questions bordering on these other areas are raised, to encourage the student to proceed to further readings. (The select bibliographies at the end of each chapter may be a guide.)

I wish to express my appreciation to the authors and publishers who have granted permission to use excerpts from articles, books, and other publications in 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 omitted out of consideration for relevancy and the avoidance of repetition; tables and diagrams have been renumbered; and some 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. As a master of data sources and a friend of all librarians, Mark Eaker has provided invaluable research assistance. Christiane Jose has accomplished a *tour de force* in cheerfully and efficiently guiding the manuscript from handwritten scrawls to the printer.

Finally, I want to acknowledge my substantial intellectual debt to members of the Institute of Development Studies (University of Sussex), the series of Cambridge Conferences on Development, and the Institute of Commonwealth Studies (Oxford). My visits there always turn into tutorials of reeducation—and eventually reappear in new editions of this book.

G.M.M.

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Stanford, California

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CHAPTER I

International Poverty and Inequality

We are concerned in this book with nothing less than the future well-being of two-thirds of the world's population—the poverty-ridden peoples in the less developed countries of Asia, Africa, and Latin America. It is indeed sobering that, two centuries after the Industrial Revolution, most of the world remains poor, still suffering from inadequate standards of living.

The World Bank now emphasizes that the failure to achieve a minimum level of income above the "poverty line" has kept some 40 per cent of the peoples in the less developed countries in the condition of "absolute poverty"—a condition of life so degraded by disease, illiteracy, malnutrition, and squalor as to deny its victims basic human necessities. The persistence of absolute poverty, despite respectable achievements in rates of growth in GNP, is now of more concern than that of relative poverty, or of a "widening gap" between the rich and poor countries.

Our objective is to examine the central issues raised by the challenges of eradicating absolute poverty, reducing inequality, and creating employment opportunities. These challenges now require the international community to reassert the development priority and reshape development policies.

This reorientation has significant implications for the way development economists view the development process. It is more effective to adopt a positive approach to the promotion of development policies than to concentrate on "vicious circles of poverty" or the "causes" of poverty. Development is a process of cumulative change that results from positive forces that raise productivity.

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

These forces of development are not, however, readily identifiable. After the disappointing record of development efforts, economists can no longer rely on simple causal relations 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. In studies of several advanced countries, the "residual factor"–the unisolated source of growth–is left to account for 50 per cent or more of the increase in total output.[1] The residual is what Abramovitz calls a "measure of our ignorance" of the determinants of a rise in productivity–the complex of little understood forces which cause output per unit of utilized resources to rise.[2] Is the residual to be attributed to some intangible "human factor," perhaps related to Marshall's observation that "Man is subject to increasing returns"? Is it a matter of "creativity" or "drive for dynamic efficiency," perhaps related to motivational changes? Is it disembodied labor-saving technological change, perhaps related to better management, organization, and work procedures which reduce the labor requirement per unit of output?[3] Is it dependent on the degree of competitive pressure and motivational efficiency, perhaps related to what Leibenstein simply calls "X-efficiency"?[4] Or is it a matter of "learning by doing," such that advances in knowledge accrue from the accumulation of experience in the production process (as measured, say, by cumulated past investments), and the production function accordingly exhibits increasing returns to scale?[5]

The fundamental question remains: What are the other sources of growth that can be identified in the catch-all of the "residual" and introduced as an "input," 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

[1] R. Solow, "Technical Change and the Aggregate Production Function," *Review of Economics and Statistics,* August 1957, pp. 312–20; John W. Kendrick, *Productivity Trends in the United States,* Princeton, 1961; Edward F. Denison, *Why Growth Rates Differ,* Washington, D. C., 1967, especially Chaps. 1, 20, 21; Sherman Robinson, "Sources of Growth in Less Developed Countries: A Cross-Section Study," *Quarterly Journal of Economics,* August 1971, pp. 391–408.

[2] Moses Abramovitz, "Resource and Output Trends in the United States Since 1870," *American Economic Review, Papers and Proceedings,* May 1956, pp. 11–14. Also see, T. Balogh and P. P. Streeten, "The Coefficient of Ignorance," *Bulletin of the Oxford Institute of Economics and Statistics,* May 1963, pp. 99–107.

[3] Cf. Dale W. Jorgenson, "The Embodiment Hypothesis," *Journal of Political Economy,* February 1966, pp. 1–12.

[4] Harvey Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review,* June 1966, pp. 392–415.

[5] Kenneth J. Arrow, "The Economic Implications of Learning by Doing," *Review of Economic Studies,* Vol. 29, 1962, pp. 155–73.

attention to "efficiency" in the utilization of inputs, and a wider understanding of an economy's "learning process."

An additional theme is that national development must now occur within the international context of the coexistence of 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 late-comer 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 benefit-cost ratio of these transfers to the developing countries.

At the same time, the greater interdependence between the developed countries (DCs) and 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.

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 a "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. The analysis of what policies are needed, choice of policy instruments, and 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 emphasizes new initiatives to reduce international poverty and inequality. Chapter II then provides some perspective from the viewpoints of theory, history, and political economy. Against this background, Chapters III and IV introduce the core problems of dualism and unemployment. Chapters V to VII proceed to relate the new initiatives to resource mobilization and allocation in developing countries that are characterized by dualism and unemployment. Chapters VIII to XI examine specifically the policy issues of human-resource development, agricultural strategy, industrialization strategy, and trade strategy. The final chapter offers a more general evaluation of development policymaking and planning.

We might reach a clearer understanding of the meaning of economic development by first considering some of the misconceptions of development (section I.A). The dimensions of the problems of absolute poverty and income inequality are outlined by the selections in section I.B. These selections give special emphasis to the problems involved in the measurement of poverty and inequality, both among nations and within a nation. Finally, the selections in section I.C indicate some bases for reorienting development strategy toward the objectives of employment, distribution, and growth.

Throughout this chapter, we should be aware that poverty, inequality, and unemployment are related phenomena. Given a population's average income level, a higher level of inequality will tend to be associated with a higher level of poverty. This poverty may be expressed in absolute terms—as a number of people below a "poverty line." When, however, the poverty line is established with reference to some socially accepted "minimal" standard of living, the average income level is likely to become a reference level, and measures of absolute poverty then also reflect an aspect of relative inequality as well. The president of the World Bank, for instance, spoke in 1975 of the "absolute poor" as those having a per capita income below $50, or less than one-third of the average per capita income of their country.

Poverty is also closely related to unemployment and underemployment. As emphasized in selections in this chapter, growth does not necessarily generate employment; nor does growth necessarily benefit those suffering absolute poverty. Despite the attainment of the Development Decades' target growth rates of 5 or 6 per cent in GNP, many LDCs have witnessed rapidly rising numbers of unemployed and a greater number in absolute poverty. The dominant question of this chapter is, therefore: Who benefits from development?

I.A. MISCONCEPTIONS OF DEVELOPMENT–NOTE

Dissatisfaction with the results during the first generation of development in the 1950s and 1960s has led to a refocusing of strategy to meet the second-generation 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 which 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–for example, legal or administrative development. 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 (see Chapter II). 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 XI, below.

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 appro-

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