INTERNATIONAL: 'Development' strategies face rethink

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Abstract (summary)

'Development' -- what it is and why it matters.

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Full Text

SUBJECT:'Development' -- what it is and why it matters.

SIGNIFICANCE: For over six decades, Western governments have sought to accelerate the pace of economic change in developing economies by promoting various development strategies. Yet assessing the effects of these efforts, the conflicting political and economic interests involved, and the best approaches remains highly controversial.

ANALYSIS: Although both Adam Smith and Karl Marx had previously described 'development' as a series of socioeconomic stages, the modern problem of economic development was formulated only during the war-torn 1940s:

The key challenge was whether governments could play a role in engineering economic transformation in poor countries.

Significantly, this question was not about how socioeconomic development had happened in the past, or what patterns of development could be found in history.

Instead, the thrust behind the new economics of development was that governments wanted urgent guidance from economists on how to make development happen differently in the future and, especially, how to accelerate the process of change.

Key insights

For the past 60 years, Western-sponsored 'development' programmes have sought to simulate the pace of economic advancement and change in poorer areas of the world.

Early development strategies, which were predicated on heavy state involvement in a 'big push' towards industrialisation, left much to be desired.

Yet more recent neo-liberal schemes have also proven problematic; the most conspicuous examples of development 'successes' in the past 25 years have occurred in East Asia, where government was very much involved in the process.

The development push has also been eroded, from some Western perspectives, by environmental concerns -- which question some positive premises of growth.

The 'big push' theory In 1943, Austrian economist Paul Rosenstein-Rodan argued that a significant share of the labour force in the poor agricultural economies of East and South-eastern Europe was in a state of 'disguised unemployment':

This meant that they were in low productivity occupations that added little either to aggregate output or aggregate demand.

To improve their lot, the agrarian excess population either had to migrate to find capital to work with (an option rejected by governments), or capital had to be brought to them to create more productive and better paid occupations -- through industrialisation of the country where they lived.

Rosenstein-Rodan advocated a 'big push', or large-scale industrial investment, diversified across a wide range of labour-intensive light wage goods industries, to generate an increased supply that was matched to the additional demand created by the investment expenditure.

Engineering demand Industrialisation via this mode was something new. Not driven by technical progress, it was an attempt to apply existing technology in the 'international depressed areas'. It depended on the engineering of complementary demand, and would therefore not happen -- or would not happen as quickly -- if left to private sector initiatives. It had to be planned by the state, and partly funded from international sources of capital. It provided a regional solution, independent of other parts of the international trade system, in order to avoid disrupting the broader international division of labour. This gave Western governments a formula to engineer a quick forward advance in industrialisation.

Vogue for 'economic dualism' By the 1950s, the excess global agrarian population was considered surplus labour, which could be transferred progressively from rural into modern industrial employment:

Reallocating labour The theory assumed that such labour transfers could take place without pushing up the industrial real wage, and without any diminution of agricultural production. The process could continue for as long as any surplus labour remained in the agricultural sector, and the constant industry wage rate allowed capitalists in the industrial sector to re-invest their profits continuously and thereby expand their output, and their demand for labour. This process would increase the share of industry in national output, a rising share of profits in national income and a rising share of savings and investment in national expenditure. These structural changes would end only when the real wage in industry finally began to rise because of labour shortages.

Overemphasis on capital investment? One reaction to the strategy of development by industrialisation was to question the emphasis on capital investment in promoting growth, particularly:

the potentially diminishing returns to the accumulation of physical capital; and

an overly narrow view of what constitutes 'capital' -- which may include individuals' and families' own investments in education and training, producing the lifetime stocks of skills that could be deployed to earn future income.

In response, policymakers gradually shifted their attention to the role of human capital in growth, and the importance of educating the men and women whose capacities were complementary to those of machines and automated processes in bringing about industrial development.

Bias against agriculture? Critics also rejected the negative view of agriculture implied by the industrialisation strategy. It was potentially inefficient and inequitable to pour more resources into the industrial sector, given that it was already relatively well endowed in these areas. The agricultural sector could itself be the starting point for growth:

As urban food shortages began to slow industrialisation drives in India, China and elsewhere in the 1960s and 1970s, this alternative strategy gained momentum.

It was based on advances in agrarian technology, particularly the bio-engineering of improved seed varieties, increased application of chemical fertilisers and use of irrigation.

This 'green revolution' can lower food prices and raise the profitability of non-agricultural investments, and provide cheap raw materials for the emergence of rural agro-based industries, and thus promote more widespread development.

Gauging government interventions Yet the question of development hinges on what governments can to do to accelerate it, and this implied heavy state involvement in macroeconomic planning, which was often problematic:

Incoherent planning The practical problem for both the industrialisation and green revolution strategies was how to move beyond the compiling of incoherent lists of possible investment projects. National planners used the national accounts and the inter-industry input-output table to calculate in a consistent way the implications of a given growth rate for the composition of both final demand and inter-industry demand. However, consistency is a minimum requirement of good planning: the key skill is to identify correctly the economic and political constraints that will bind during the course of growth, and to judge the maximum feasible rate of growth that the country can achieve. This skill was often lacking in practice.

Improving cost assessment Any sensible macroeconomic plan indicates the appropriate amount of investment in aggregate, but it does nothing to bring coherence to the list of investment projects. What was needed was a technique that would allow projects to be undertaken in the order of their economic desirability, until the investment budget was exhausted. The integration of various partial investment criteria within a single procedure of appraisal of net present value was the important analytical breakthrough of the 1970s. It was based on measuring the true cost of transferring a marginal unit of rural labour to urban employment, rather than assuming that the transfer was costless.

Social cost-benefit analysis It became clear that the valuation of a project's non-labour inputs and outputs was difficult owing to many ad hoc government interventions in markets that distorted prices. The idea of a price distortion made sense only relative to some standard of undistorted prices, and world prices were adopted as that standard. The use of world prices as a norm marked a significant shift in economic thinking about development, even though in practice social cost-benefit analysis techniques were hardly more successful than macroeconomic planning.

Contemporary development strategies This last innovation focused attention on development strategies linked to trade and foreign investment, and away from inward-looking and protectionist policies. Ultimately, this approach became the cornerstone of contemporary approaches to the subject:

Eliminating internal constraints While the industrialisation and green revolution strategies were by no means predicated on closed economies, they tended to take a pessimistic view of trade possibilities, emphasising external constraints on trade imposed by developed countries. Policymakers in developing countries now acknowledge that some of the obstacles impeding trade are internal, and not merely external.

Measures of the effective rate of protection, rather than the nominal rate, revealed the overall structure of protection, not just the height of individual tariffs. The effective rate of protection of some industries was at times twice as high as the nominal rate, often approximately 100%. This suggested that many governments, such as Mexico and Pakistan, had been exploiting agriculture, and not just neglecting it, in order to prop up internationally uncompetitive industries. This lesson went home with the leaders of many developing countries.

External private sector involvement The advent of detailed microeconomic analysis of government policy motivated a new outward-looking, open-economy strategy for development. This is based on removing those policies that discriminate against those national firms that want to export, and also policies that discriminate against those foreigners who want to bring private investment into the country. Instead of relying on foreign aid to fill any balance of payments gap that emerges automatically, private foreign direct investment needed to be positively encouraged.

The role of the government in this strategy is to improve supply capacity, by improving the infrastructure, both physical (eg, transport, ports, power, research) and financial (eg, credit, bank regulation). The government still has a central role, but it is a different one -- paving the way for globalisation under the discipline of WTO rules.

Ascendant neo-liberalism Such neo-liberal approaches have been buoyed by negative views of the performance of the state, not least in developing countries. Analysts explain the failure of development policies in terms, not of the conflict between development and other government objectives, but of conflict between development and governments' 'hidden agendas':

These cover the class basis of the state, its urban bias and its vulnerability to corruption.

The World Bank favours a policy programme of minimising the role of the state in development and of 'getting prices right'.

Governments are now adjured to divest themselves of state-owned industries and to liberalise comprehensively -- in goods markets, labour markets, financial markets, capital markets and foreign trade markets.

They are encouraged to concentrate their efforts on law and order, and providing education and health services.

These views became codified in 'the Washington consensus' on economic policy for developing countries, and its subsequent modifications.

Champions of the free price mechanism have celebrated the economies of East Asia, especially South Korea and Taiwan, as examples of the rapid growth and favourable income distribution which results from economic liberalisation. However, despite inter-country differences, the East Asian growth story is couched in government and businesses coordination to secure high investment, high saving and re-investment and rapid growth of competitive exports in a joint strategy of national development, which was never entirely outward-looking or neo-liberal.

Structural adjustment For many countries whose balance of payments gap is no longer filled by expanding foreign aid grants, adjustment means reducing aggregate demand to equal aggregate supply, plus whatever amount sustainable borrowing can finance. However, a simple reduction in absorption would typically create an imbalance between the supply of and demand for non-traded goods, so that devaluation of the exchange rate normally accompanies the contraction of demand. After successful macroeconomic stabilisation, the removal of price distortions, plus the shrinkage of the public sector, is intended to provide the impulse to resumed growth.

Disappointing record In general, the verdict on the structural adjustment strategy is that it delivers much less than its advocates have claimed for it. Exports and overall growth do grow slightly as a result, but the share of investment to GDP declines somewhat. Economic reform is a very large policy package, composed of stabilisation, liberalisation and privatisation, and each of these sub-categories of policy consists of many different specific actions that, for success, should be pursued in a coordinated programme. Development economists are not well equipped to resolve the practical issue of the sequencing of this package of policies. Evaluations have shown that important sequencing errors are one of the factors that blunts the effectiveness of contemporary development strategy (*see AFRICA: Panel backs Kaberuka strategy for AfDB reform - February 15, 2008*).

Looking to the future For 60 years, the question of development has been whether governments can accelerate economic growth and structural change. A succession of strategies has been tried; all have achieved some success in particular countries; all are also capable of being implemented quite damagingly. None of them has proved to be a panacea:

A role for government Much of the initial enthusiasm for government intervention to promote development has evaporated, as scepticism has dissolved public confidence in benevolent government. Yet in the relatively few countries where rapid development, including observable poverty reduction, has taken place -- mainly in Asia -- the contribution of the government to development has not been negligible. The question of how to engineer development has still not been fully answered (*see CHINA: Beijing intervenes to manage risks - January 24, 2008*).

A role for migration? At the same time, the fact that economic development in many countries (especially in Africa) has not responded well to strategies tried so far has put the question of economic migration back on the international agenda. The one government restriction that many neo-liberals does not want to abolish is on the free movement of labour. Yet there is no economic law that ordains that every location where people live is capable of undergoing development. If international disparities in welfare continue to enlarge, the incentives for more migration, and more disorderly migration, will increase also.

Environmental factors The question of development has been overshadowed in recent years by the question of the environment. The happy presumption that economic growth can continue without limit in all parts of the world is now under suspicion. Increased pollution, carbon emissions and loss of forest cover, which contribute to global warming and climate change, are the increasingly visible effects of successful development strategies. In countries such as China, Brazil, India, Indonesia and Malaysia, awareness of the costs of economic growth and the diseconomies of scale, which has remained a minor theme in the development literature, is in future likely to loom much larger in public debate (*see SCIENCE/TECHNOLOGY: Climate costs deemed 'reasonable' - May 7, 2007*).

CONCLUSION: Early efforts to use heavy state intervention to stimulate demand and industrialisation, and more recent neo-liberal development strategies, have both been disappointing. In the future, governments may again have a more prominent role in development efforts -- given the successful examples provided by some East Asian economies -- if the development project does not entirely fade from the global agenda.

Indexing (details)

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