

## **CHAPTER 2 APPROACHES TO ECONOMIC DEVELOPMENT**

### **2.1 INTRODUCTION**

This chapter provides an analysis of international literature on economic development. The aim is to highlight major approaches to economic development in a historical context. The chapter will mainly be based on post World War II writings on economic development. Four schools of economic thought and their implications will be discussed. These approaches are: the linear stages of growth model, theories and patterns of structural change, the international dependency revolution, and the neoclassical theories.

The term economic development is a term that economists, politicians, and others have used frequently. The term could mean different things to different people. Its definition could depend on the circumstances or the time period one is within. Various writings on the concept of economic development have stimulated debates on its meaning and the means to achieve economic development. This progress in economic thought will be analysed in this chapter, starting with different definitions of economic development.

### **2.2 DEFINITIONS OF ECONOMIC DEVELOPMENT**

Economic development can be defined as social and technological progress. It typically refers to improvements in a variety of indicators such as literacy rates, life expectancy and poverty rates. The understanding of development can differ among countries and even among individuals, but it usually goes far beyond the objective of increased average income to include things like freedom, equity, health, education, *safe environment*, and much more (Soubbotina, 2004:1).

Todaro (1994:18) cites that development is both a physical reality and a state of mind in which society has, through some combination of social, economic, and institutional processes, secured the means for obtaining a better life. The World Bank (1991:49) attests that development must be conceived as a multidimensional process involving major changes in social structures, popular attitudes, and national institutions, as well

as the acceleration of economic growth, the reduction of inequality, and the eradication of poverty. Todaro (1994:18) argues that, whatever the specific components of this better life, development in all societies must have at least the following three objectives:-

- To increase the availability and widen the distribution of basic life-sustaining goods such as food, shelter, health, and protection;
- To raise living standards, including and in addition to higher incomes, the provisions of more jobs, better education, and greater attention to cultural and humanistic values; and
- To expand the range of economic and social choices available to individuals by freeing them from servitude and dependence (Todaro, 1994:18).

According to Todaro (1994:14), economic development in its basic understanding has traditionally meant the capacity of a national economy, whose initial condition has been more or less static for a long time, to generate and sustain an annual increase in its gross national product. A common alternative index of development has been the use of rates of growth of income per capita to take into account the ability of a nation to expand its output at a rate faster than the growth rate of its population.

Economic development can also be defined as the sustainable increase in living standards. It implies increased per capita income, better education and health as well as environmental protection. The economic development process supposes that legal and institutional adjustments are made to give incentives for innovation and for investments so as to develop an efficient production and distribution system for goods and services (Anon, 2006). The focus of public policy is on continuous and sustained economic growth and expansion of national economies so that developing countries become developed countries (Todaro, 1994:14).

Economic development is also viewed as the development of economic wealth of countries or regions for the wellbeing of their inhabitants. It is the process by which a nation improves the economic, political, and social wellbeing of its people. From a policy perspective, economic development can be viewed as efforts that seek to

improve the economic wellbeing and quality of life for a community by creating and/or retaining jobs and supporting or growing incomes and the tax base (Sullivan & Sheffrin, 2003:471).

Durning (1990:24) writes that in better resourced nations development is synonymous with material wellbeing based on high levels of consumption. Using this analysis, economic development is the creation of economic wealth for all citizens within the diverse layers of society so that all people have access to potential increased quality of life. Job creation, economic output and increase in taxable basis are the most common measurement tools.

According to Herrick and Kindleberger (1977:1), economic development is generally defined to include improvements in material welfare, especially for persons with the lowest incomes; the eradication of mass poverty with its correlates of illiteracy, disease and early death; changes in the composition of inputs and outputs that generally include shifts in the underlying structure of production away from agricultural toward industrial activities; the organisation of the economy in such a way that productive employment is general among the working-age population rather than the situation of a privileged minority; and the correspondingly greater participation of broadly based groups in making decisions about the directions, economic and otherwise, in which they should move to improve their welfare.

According to Hunt (1989:49), an underdeveloped economy is one in which the technological level of some branches of the economy falls below the technological level (and hence labour productivity) of the most advanced sector, and well below the level that could be achieved with known technologies. Van Wyk (2004:15) defines economic development as the sustained improvement, in the long term, of the material and spiritual welfare of people through the sustainable alleviation of poverty and inequality, and the creation of adequate and suitable job opportunities for all.

The concept of economic development can also be viewed from a basic needs approach, which is said to be more than economic growth. The basic needs approach views economic development as a steady, measurable progress towards absolute poverty elimination and a sustained expansion in the employment opportunities and

incomes of the poor (Hunt, 1989:77). The rationale is that, if the basic needs of people are provided for, people will be more productive and economic growth will be stimulated. The basic needs could be listed as follows:

- Nutrition (intake of kilojoules);
- Education and literacy (level of literacy);
- Health (life expectancy);
- Provision of water and housing (Lewis, 1995:18).

Economic development has many meanings. These alternative definitions create many different viewpoints with regards to its meaning and implications, as well as the means to achieve it. The meaning one attaches to the term largely depends on his/her subjective view of the world. The meaning of economic development is not only a product of the individual's perspective but also of the particular period in time when the word is being uttered. This is the reason why in order to understand the various theories of development one must place them in a historical context (Conteras, 1998:5). The sections that follow will be dedicated to major approaches to economic development from a historical perspective.

### **2.3 THE LINEAR STAGES OF DEVELOPMENT**

According to Seligson and Passe-Smith (2003:126), the study of early economic development theory is said to be an extension of conventional economic theory which equated development with growth and industrialization. As a result, Latin American, Asian and African countries were seen mostly as underdeveloped countries, i.e. primitive versions of European nations that could, with time, develop the institutions and standards of living of Europe and North America. Stage theory mentality of economic development dominated discussions of economic development during this era.

The stages theory, made famous by Alexander Gerschenkron (1953, 1962) and later by Walt W. Rostow (1960), argues that all countries passed through the same historical stages of economic development and that current underdeveloped countries

were merely at an earlier stage in this linear historical progress, while First World (European and North American) nations were at a later stage (Seligson & Passe-Smith, 2003:126).

The stages theory further postulates that developed nations had no readily available conceptual apparatus with which to analyse the process of economic growth in largely peasant, agrarian societies characterized by the virtual absence of modern economic structures. The theory was based on the fact that the right quantity and mixture of saving, investment and foreign aid were all that was necessary to enable Third World nations to proceed on an economic path that historically had been followed by the more developed nations. Development thus became synonymous with rapid aggregated economic growth (Todaro, 1994:68). Two models; Rostow's stages of growth and the Harrod-Domar model which forms the basis of the stages theory, will be discussed.

### **2.3.1 Rostow's stages of growth**

Rostow's stage of growth is one of the major historical models of economic growth. It was developed by W.W Rostow. Rostow (1960:4-16) premised that countries go through stages of development fairly linearly. The model set out a number of conditions that were likely to occur in investment, consumption and social trends at each stage. Not all of the conditions were certain to occur at each stage, and transition periods may occur at varying lengths from country to country, and even from region to region. The theory asserts that the transition from underdevelopment to development can be described in terms of a series of steps which all countries must go through. The model argues that economic modernization occurs in five basic stages of varying length: the traditional society, preconditions for take-off, take-off, drive to maturity, and age of high mass consumption.

According to the model, it is possible to identify all societies according to their dimensions, as lying within one of the above categories. These stages are not merely descriptive. They are not ways of merely generalizing certain factual observations about the sequence of development of major societies but are an inner logic and continuity through development (Ford, 2004).

### **2.3.1.1 Traditional society**

Traditional society is one whose structure is developed within limited production functions. The economy is dominated by subsistence activity where output is consumed by producers rather than traded. Any trade is carried out by barter where goods are exchanged directly for other goods. Agriculture is the most important industry and production is labour intensive using only limited quantities of capital. Resource allocation is determined very much by traditional methods of production (Ford, 2004).

The conception of the traditional society is, however, in no sense static and would not exclude increases in output. Highly productive innovations could be introduced in trade, industry and agriculture and can result in increase in productivity, for example, the improvement of irrigation works or the discovery and diffusion of a new crop. The central fact about the traditional society was that a ceiling existed on the level of attainable output per head. This ceiling resulted from the fact that the potential which flows from modern science and technology were either not available or not regularly and systematically applied (Rostow, 1960:4).

### **2.3.1.2 Preconditions for take-off**

The second stage of growth embraces societies in the process of transition. This is the period wherein the preconditions for take-off are developed. Rostow's (1960:5) argument was that it takes time to transform a traditional society in the ways necessary for it to exploit the fruits of modern science, and to fend off diminishing returns. The model postulates that not merely economic progress is possible, but that economic progress is a necessary condition for some other purpose, judged to be good: be it national dignity, private profit, the general welfare, or a better life for the children. During this stage education, for some at least, broadens and changes to suit the needs of modern economic activity. Investment increases, notably in transport, communications, and in raw materials in which other nations may have an economic interest. The scope of commerce, internal and external, widens. This activity proceeds at a limited pace within an economy and a society still mainly characterized by traditional low-productivity methods (Rostow, 1960:5).

During the preconditions for take-off, increased specialization generates surpluses for trading. The emergence of a transport infrastructure support increased trade. As incomes, savings and investment grow, entrepreneurs emerge. External trade concentrated on primary products increases during this stage. Although the period of transition between the traditional society and the take-off saw major changes in both the economy itself and in the balance of social values, a decisive feature was often political. Politically, the building of an effective centralized national state on the basis of coalitions touched with a new nationalism, in opposition to the traditional landed regional interests was a decisive aspect of the preconditions period. The assertion is that this was almost a universally necessary condition for take-off (Ford, 2004).

### **2.3.1.3 Take-off**

The take-off is the interval which takes place when the old blocks and resistances for steady growth are finally overcome. The forces making for economic progress, which yielded limited bursts and enclaves of modern activity, expand and come to dominate the society. In many economies, the proximate stimulus for take-off was mainly (but not wholly) technological. In a more general case, the take-off awaited not only the build-up of social overhead capital and a surge of technological development in industry and agriculture, but also the emergence to political power of a group prepared to regard the modernization of the economy as serious, high-order political business. During the take-off, the rate of effective investment and savings may rise from, say, 5 % of the national income to 10% or more. In areas where heavy social overhead capital investment was required to create the technical preconditions for take-off, the investment rate in the preconditions period could be higher than 5% (Rostow, 1960:6).

Ford (2004) asserts that during this period, industrialization increases, with workers switching from the agricultural sector to the manufacturing sector. Growth is concentrated in a few regions of the country and in one or two manufacturing industries. The economic transitions are accompanied by the evolution of new political and social institutions that support the industrialization. The growth is self-sustaining as investment leads to increasing incomes and in turn generates more savings to finance further investment.

#### **2.3.1.4 Drive to maturity**

After take-off there follows a long interval of sustained progress, as the now regularly growing economy drives to extend modern technology over the whole front of its economic activity. The drive to maturity is evident by a steady investment of some 10-20% of the national income, permitting output to regularly outstrip the increase in population. The make-up of the economy changes unceasingly as technique improves, new industries accelerate, and older industries level off. The international competitiveness of the economy improves as goods formerly imported are produced at home. The society makes such terms as it will with the requirements of modern efficient production, balancing off the new against the older values and institutions, or revising the latter in such ways as to support rather than to retard the growth process (Rostow, 1960:7).

During the drive to maturity stage, the economy is diversifying into new areas. Technological innovation is providing a diverse range of investment opportunities. The economy is producing a wide range of goods and services and there is less reliance on imports (Ford, 2004). The drive to maturity period is characterised by regular, expected, and self-sustained growth. This stage is characterized by a labour force that is predominantly urban, increasingly skilled, less individualistic, and more bureaucratic and looks increasingly to the state to provide economic security (Nafziger, 1997:92).

#### **2.3.1.5 Age of high mass consumption**

In this stage of economic development, the leading sectors shift towards durable consumer goods and services. During this stage, real income per head rises to a point where a large number of persons gained a command over consumption. The structure of the working force changed in ways which increased not only the proportion of urban to total population, but also the proportion of the population working in offices or in skilled factory jobs (Rostow, 1960:8).

In addition to these economic changes, the society ceased to accept the further extension of modern technology as an overriding objective. It is in this post-maturity stage, for example, that, through the political process, western societies are said to



have chosen to allocate increased resources to social welfare and security. The emergence of the welfare state is one manifestation of a society moving beyond technical maturity. This stage is also characterised by the directing of resources to the production of consumer durables and to the diffusion of services on a mass basis. The sewing-machine, the bicycle, and then the various electric-powered household gadgets were gradually diffused. Historically, however, the decisive element has been the cheap mass automobile with its quite revolutionary effects, social as well as economic on the life and expectations of society (Rostow, 1960:8).

According to the model, development requires substantial investment in capital. For the economies of least developed countries to grow, the right conditions for such investment would have to be created. If aid is given or foreign direct investment occurs at stage 3, the economy needs to have reached stage 2. If stage 2 has been reached then injections of investment may lead to rapid growth (Ford, 2004). The symbols of this stage, reached in the United States in the 1920s and in Western Europe in the 1950s, are the automobile, suburbanization, and innumerable durable consumer goods and gadgets. In Rostow's view, other societies may choose a welfare state or international military and political power (Nafziger, 1997:92).

### **2.3.1.6 Conclusions and Implications**

An important implication of the model is that development requires substantial investment in capital equipment. To foster growth in developing nations, the right conditions for such investment would have to be created i.e. the economy needs to have reached stage 2. The model assumes the following:

- Savings and capital formation (accumulation) are central to the process of growth hence development;
- The key to development is to mobilise savings to generate the investment to set in train self generating economic growth; and
- Development can stall at stage 3 for lack of savings in relation to the national output (Todaro, 1994:73).

The model is historical in the sense that the end result is known in the outset and is derived from the historical geography of developed society. The theory assumes a strong bias towards a western model of modernization. It de-emphasises any difference between how leading sectors develop in free and controlled markets. However, Rostow's consideration of non-western cases such as China shows that to some extent, modernization can be achieved in different ways and through free market or controlled economic means and still fit into his model. It is more at his description of the final stage, the age of high mass consumption, where controlled economies seem mostly to find no niche in Rostow's work. Even there, though, it could be said that the society seeks out economic equality at the complete detriment of any luxury. In addition, its generalized nature makes it somewhat limited. It does not set down the detailed nature of the pre-conditions for growth. In reality, policy makers are unable to clearly identify stages as they merge together. Perhaps its main use is to highlight the need for investment (Ford, 2004).

The most rudimentary assumption that Rostow is accused of, is trying to fit economic progress into a linear system. This charge is correct in that many countries make false starts, reach a degree of transition and then slip back. According to Rostow, if a country can be disciplined in promoting investment, and can identify sectors where it has some sort of advantage, it can enter into transition and eventually reach modernity. Rostow would point to a failure in one of these conditions as a cause for non-linearity (Rostow, 1960:10; Todaro, 1994:73). The determinants of a country's stage of economic development are usually seen in broader terms, dependent on, amongst other issues, the quality and quantity of resources, a country's technologies, and a country's institutional structures (Todaro, 1994:73).

### **2.3.2 The Harrod-Domar growth model**

Evsey Domar and Roy Harrod were the co-founders of a neo-Keynesian approach to modelling economic growth. Following their contribution in the period 1939-47, their model became popularly known as the Harrod-Domar growth model even though there were differences in their respective contributions. For example, according to Easterly (2001), Domar never intended his model to be used as a growth model, but

was intending to make a contribution to the analysis of employment in a business by establishing a link between employment and capital formulation. Domar was concerned that early Keynesian economists concentrated too much on the short run multiplier effects of investment expenditures, and were neglecting the impact of investment on the productive capacity of an economy. In contrast to Domar, the explicit objective of Harrod was dynamism of the Keynesian theory. He was concerned that the Keynesian models needed to be extended to take into account the impact of growth and investment and in so doing produced a theory of the trade cycle which combined the concept of the multiplier and the accelerator.

The Harrod-Domar model focuses on two critical aspects of the growth process: saving and the efficiency with which capital is used in investment. This model can provide accurate short term predictions of growth and has been used extensively in developing countries to determine the required investment rate or financing gap to be covered in order to achieve a target growth rate. The model suggests that every economy must save a certain proportion of its national income to replace worn out or impaired capital goods. In order to grow, new investments representing net additions to the capital stock are necessary. The rate of growth of the gross national product is determined jointly by the national savings ratio and the national capital output ratio (Todaro, 1994:70-72).

According to Ghatak (1995:510), the model makes the following assumptions:

- The labour market grows against steady rate;
- Savings and investments are a fixed ratio of total output; and
- Labour and capital are used in a fixed ratio.

The model assumes a direct economic relationship between the size of the capital stock and total GDP. The rate of economic growth is the direct product of the investment-output ratio and the output-capital ratio. If  $R_3$  of capital is always necessary to produce a  $R_1$  stream of GDP, it follows that any net additions to the capital in the form of new investment will bring about corresponding increases in the flow of national output, GDP (Todaro & Smith, 2006:06). The change in productive

capacity will depend on the level of investment and the potential average productivity of new investment. The model makes the following findings:

- Economic growth depends on the amount of labour and investment;
- Developing countries have an abundant supply of labour. It is lack of physical capital that holds back economic growth and economic development;
- More physical capital generates economic growth; and
- New investment, over and above that needed to replace worn out equipment, leads to more capital intensive goods, which in turn generate higher output and income. Higher income allows for increased level of savings (Easterly, 2001).

### **2.3.2.1 Conclusions and Implications**

Although the Harrod-Domar model was initially created to help analyse the business cycle, it was later adapted to explain economic growth. Its implications were that growth depends on the quantity of labour and capital; more investment leads to capital accumulation, which generates economic growth. The model also had implications for less economically developed countries; labour is in plentiful supply in these countries but physical capital is not, thus slowing economic progress. Least developed countries do not have sufficient average incomes to enable high rates of saving, and therefore accumulation of the capital stock through investment is low (Kasliwal, 1995:107).

The model implies that economic growth depends on policies to increase investment by increasing saving, and using that investment more efficiently through technological advances. The main obstacle to or constraint on development, according to the theory, is the relatively low level of new capital formation in most poor countries. As an example, if a country wanted to grow at, say a rate of 7% per year and if it could not generate savings and investment at a rate of 21% of national income (assuming a capital-output ratio of 3) but could only save 15%, it could seek to close this savings gap of 6% through either foreign aid or private foreign investment. The model concludes that an economy does not find full employment and stable growth rates naturally (Todaro & Smith, 2006:107).

The model assumes that the relative price of labour and capital is fixed, and that they are used in equal proportions. It explains economic boom and bust by the assumption that investors are only influenced by output (known as the accelerator principle). In terms of development, critics claim that the model sees economic growth and development as the same. In reality, economic growth is only a subset of development. Another criticism is that the model implies poor countries should borrow to finance investment in capital to trigger economic growth; however, history has shown that this often causes repayment problems later (Kasliwal, 1995:107).

## **2.4 STRUCTURAL CHANGE MODELS**

The patterns of structural change models are concerned with mechanisms by which underdeveloped countries transform their economic structures from a heavy emphasis on traditional subsistence agriculture to a more modern, urbanized, and more industrially diverse manufacturing and service economy. It employs the tools of price and resource allocation theory and modern econometrics to describe how this transformation takes place (Todaro, 1994:74). Two models which will be discussed are: the two sector model developed by W. Arthur Lewis, and the patterns of development theory of Hollis B. Chenery.

### **2.4.1 The Lewis theory of development**

The Lewis theory of development, also known as the two sector model, was developed in the 1950s by Arthur Lewis. It was based on the assumption that many least developed countries had dual economies with both a traditional agricultural sector and a modern industrial sector. The traditional agricultural sector was assumed to be of a subsistence nature characterised by low productivity, low incomes, low savings and considerable underemployment. The industrial sector was assumed to be technologically advanced with high levels of investment operating in an urban environment (Lewis, 1954:132).

Lewis suggested that the modern industrial sector would attract workers from the rural areas. Industrial firms, whether private or publicly owned, could offer wages that would guarantee a higher quality of life than remaining in the rural areas could provide.

Furthermore, as the level of labour productivity was so low in traditional agricultural areas, people leaving the rural areas would have virtually no impact on output. The model illustrates how an underdeveloped country could transform its economy from a static state to a dynamic state (Lewis, 1954:132).

During the 1950s much emphasis was placed on the causes of underdevelopment and how it could be overcome. An important juncture was on how to finance the process of industrialisation. Lewis described the main problem as how to increase the level of savings (Lewis, 1954:132). In the Lewis model, the underdeveloped economy consists of two sectors:

- A traditional, overpopulated rural subsistence sector characterized by a zero marginal labour productivity. This situation is characterized by surplus labour which can be withdrawn from the agricultural sector without any loss in output;
- A high productivity modern urban industrial sector into which labour from the subsistence sector is gradually transferred.

Lewis (1954:139) analyses the process of economic expansion in a dual economy composed of a capitalist sector and a non-capitalist sector. The capitalist sector is defined as part of the economy that uses reproducible capital, pays capitalists for the use thereof, and employs wage labour for profit making purposes. The subsistence sector is that part of the economy that does not hire labour for profit. In this sector, output per head is much lower than that in the capitalist sector. A fundamental relationship between the two sectors is that when the capitalist sector expands, it draws labour from the excess capacity in the non-capitalist sector.

The focus of the model is on the transfer of labour and the growth of output and employment in the modern sector. According to the model, both labour transfer and modern sector employment growth are brought about by output expansion in that sector. The speed with which this expansion occurs is determined by the rate of industrial investment and capital accumulation in the modern sector (Todaro, 1994:74).

In the model, Lewis drops a common neoclassical assumption that the supply of labour was fixed. He instead assumes that labour supply is infinitely elastic. The source of this infinite supply of labour is disguised unemployment in agriculture, technological unemployment and underemployment in urban areas or the informal sector, and most of all the increase in population (Lewis, 1954:132). The model further assumes that limited land causes diminishing marginal product for agricultural labour. The model is based on the assumption that most least-developed countries have a conspicuous reserve army of the unemployed that can be put to work in a dynamic new sector to generate growth. When the marginal worker is transferred from agriculture to the more productive industrial sector, the result is an increase in aggregate output. This transfer will continue over time as industrial demand for labour expands to absorb the surplus labour (Kasliwal, 1995:98).

Todaro & Smith (2006:112-113) critiqued Lewis' model for making the following assumptions:

- It assumes that labour is transferred and employment is created as capital accumulates in the modern sector. The faster the rates of capital accumulation, the higher the growth rate of the modern sector and the faster the rate of new job creation. But what if capitalist profits are reinvested in more sophisticated labour absorbing capital equipment rather than just duplicating the existing capital as is implicitly assumed by Lewis mode?
- It assumes surplus labour in agriculture and full employment in urban areas. Most contemporary research indicates that there is little general surplus labour in rural locations.
- It assumes a competitive modern sector labour market that guarantees the continued existence of constant real urban wages up to the point where the supply of rural surplus labour is exhausted. Institutional factors such as union bargaining power tend to negate the competitive forces in labour markets.
- It assumes diminishing returns in the modern industrial sector, yet there is much evidence that increased returns prevail in this sector, posing problems for development policy making (Todaro & Smith, 2006:112-113).

## 2.4.2 Theories and patterns of structural change theory

The model focuses on the sequential process through which the economic, industrial, and institutional structure of an underdeveloped economy is transformed over time to permit new industries to replace traditional agriculture as the engine of economic growth. However, in contrast to the Lewis model, increased savings and investment are perceived as necessary but not sufficient conditions for economic growth. In addition to the accumulation of capital, both physical and human, a set of interrelated changes in the economic structure of a country are required for the transition from a traditional economic system to a modern one. These structural changes involve virtually all economic functions. These includes the transformation of production and changes in the composition of consumer demand, international trade, and resource use as well as changes in socio-economic factors such as urbanisation and the growth in distribution of a country's population (Todaro, 1994:79).

The best known model of structural change was the one based on the work of Hollis Chenery. Chenery's work was wide ranging but might be summarised as involving the analysis of patterns of development, the use of a two-gap model and multi-sectoral analysis. Chenery identified five characteristic features (not necessary conditions) of the development process of the countries that have developed (Syrquin, *et al.*, 1984):

- Shift from agriculture to industrial production;
- Steady accumulation of physical and human capital;
- Change in composition of consumer demand;
- Growth of cities and urban areas; and
- Decline in family sizes and overall population growth (Syrquin, *et al.*, 1984).

Structural change models hypothesise that development is an identifiable process of growth and change whose main features are similar in all countries. However, the model recognises that differences can arise among countries in the pace and patterns of development, depending on their particular set of circumstances. Factors influencing the development process include a country's resource endowment and



size, its government's policies and objectives, the availability of external capital and technology, and the international trade environment (Todaro & Smith, 2006:14).

## 2.5 THE INTERNATIONAL DEPENDENCY REVOLUTION

International dependence theories gained prominence in the 1970s as a reaction to the failure of earlier theories to lead to widespread successes in international development. Unlike earlier theories, international dependence theories have their origins in developing countries and view obstacles to development as being primarily external in nature, rather than internal (Meier & Seers, 1984:45). Todaro (1994:81) writes that international dependency models view Third World countries as beset by institutional, political and economic rigidity, both domestic and international, and are caught up in a dependence and dominance relationship to rich countries.

Tausch and Prager (1993:52) cite that dependency theories are predicated on the notion that resources flow from a periphery of poor and underdeveloped states to a core of wealthy states, enriching the latter at the expense of the former. It is a central contention of dependency theory that poor states are impoverished and rich ones enriched by the way poor states are integrated into the world system. The dependency theory is premised on the following (Tausch & Prager, 1993:52):

- Poor nations provide market access to wealthy nations (e.g., by allowing their people to buy manufactured goods and obsolete or used goods from wealthy nations), permitting the wealthy nations to enjoy a higher standard of living;
- Wealthy nations actively perpetuate a state of dependence by various means. This influence may be multifaceted, involving economics, media control, politics, banking and finance, education, culture and all aspects of human resource development (including recruitment and training of workers); and
- Wealthy nations actively counter attempts by dependent nations to resist their influences by means of economic sanctions and/or the use of military force.

According to Meier (1995:108), dependency theories contend that the developing city exploits the underdeveloped periphery in various ways. These include *biasing its*

structure of production toward the supplying of raw materials, by the external drain of capital, and by thwarting autonomous national development. Three schools of thought which have dominated the international dependency thinking, will be discussed i.e. the neo-colonial model, the false-paradigm model, and the dualistic development thesis.

### **2.5.1 The neo-colonial dependence model**

According to this model, Third World underdevelopment is viewed as the result of highly unequal international capitalist system or rich country-poor country relationships. It holds the view that the rich countries through their intentionally exploitative or unintentionally neglectful policies hurt the developing countries. The rich countries and a small elite ruling class in the developing countries, who serve as the agent of the rich countries, are responsible for the perpetuation of underdevelopment in the developing countries. The small elite includes landlords, public officials, union officials, etc, who enjoy high incomes, social status, and political power whose principal interest, knowingly or not, is in the perpetuation of the international capitalist system of inequality and conformity by which they are rewarded (Todaro, 1994:81).

The advanced groups in the developing countries are more integrated economically, culturally and socially with the developed structures than with the marginalised groups. The dominant countries may bring political pressures to bear on the dependent countries, and political alliances may emerge between foreign interests and the upper strata within the dependent country. Internal polarisation and class conflict are reflections of the international polarisation and the disparities among nations (Meier, 1995:109).

### **2.5.2 The false paradigm model**

The model attributes Third World underdevelopment to faulty and inappropriate advice provided by well meaning but often uninformed, biased, ethnocentric international advisers from developed country assistance agencies and multinational donor organisations. These experts offer sophisticated concepts, elegant theoretical structures, and complex econometric models of development that often lead to

inappropriate or incorrect policy. This is due to the fact that, at times, institutional factors such as the central role of traditional social structures and the disproportionate control by local elites over domestic and international assets, based as they often are on mainstream structural change models, in many cases serve the vested interests of existing power groups, both domestic and international (Todaro, 1994:83).

In addition, leading university intellectuals, trade unionists, high level government economists, and other civil servants all get their training in developed countries institutions where they are unwittingly served an unhealthy dose of alien concepts and elegant but inapplicable theoretical models. Having little or no really useful knowledge to enable them to come to grips in an effective way with real development problems, they often tend to become unknowingly or reluctant apologists for the existing system of elitist policies and institutional structures (Todaro & Smith, 2006:116).

### **2.5.3 The dualistic development thesis**

The concept of dualism is more resonant in least developed countries, which are said to have dual economies. The two economies exist concurrently, with a modern commercialised industrial sector developed alongside a traditional subsistence agricultural sector (Meier, 1995:113). Dualism encourages asymmetries in organisation and production between these sectors. It represents the existence and persistence of increasing divergence between rich and poor nations, and rich and poor people on various levels. Dualism theories assume a split of economic and social structures of different sectors so that they differ in organisation, level of development, and goal structures (Todaro & Smith, 2006:118).

The concept of dualism embraces the following four key concepts:-

- Different sets of conditions, of which some are superior and others inferior can coexist in a given space;
- This coexistence is not merely transitional. The coexistence of wealth and poverty is not simply a historical phenomenon that will be rectified in time;

- Not only do the degrees of superiority or inferiority fail to show any signs of diminishing, but they even have an inherent tendency to increase; and
- The interrelations between the superior and inferior elements are such that the existence of superior elements does little or nothing to pull up the inferior element (Singer, 1970:60).

Dualism is characterised by the wide price differentials for apparently the same product or factor of production in the traditional and the modern sector (Myint, 1985:38). Lewis (1954:145) analyses the process of economic expansion in a dual economy composed of a capitalist sector and non-capitalist sector. The capitalist sector is defined as that part of the economy that uses reproducible capital, pays capitalists for the use thereof, and employs wage labour for profit making purpose. Output per head is much lower in the non-capitalist sector than in the capitalist sector; given the available techniques. A fundamental relationship between the two sectors is that when the capitalist sector expands, it draws labour from the excess supply in the non-capitalist sector. Development in a dualistic economy sees the traditional sector being suppressed by concentrating on and expanding the modern sector.

#### **2.5.4 Conclusions and implications**

The Lewis model tends to encourage the habit of treating the traditional sector as a black box which exists merely to provide unlimited supply of labour (Meier, 1995:131). Dependency theories are rejected because of the exclusive emphasis on traditional neoclassical economic theories designed to accelerate growth and GDP as the principal index of development (Todaro & Smith, 2006:118).

Dependency theories are said to have two major weaknesses. Firstly, although they offer an appealing explanation of why many countries remain undeveloped, they offer little formal or informal explanation of how countries initiate and sustain development. Secondly, the actual economic experience of least developed countries that have pursued revolutionary campaigns of industrialisation and state run production has been mostly negative and haven't been accounted for in the theories (Todaro & Smith, 2006:119).

## 2.6 THE NEOCLASSICAL THEORIES

The neoclassical counterrevolution favoured the privatisation of public corporations in developed nations and also called for the dismantling of public ownership and government regulation of economic activities in developing countries. The central argument of the neoclassical counterrevolution is that underdevelopment results from poor resource allocation due to incorrect pricing policies and too much state intervention by overly active developing-nation governments (Todaro, 1994:85).

The proponents of classical theories argue that by permitting competitive free markets to flourish and privatizing state-owned enterprises, both economic efficiency and economic growth will be stimulated. The model promotes free trade and export expansion, the welcoming investors from developed countries, and the elimination of the plethora of government regulations as key factors for economic prosperity. What is needed, therefore, is not a reform of the international economic system, an increase in foreign aid, or a more effective development planning system. Rather, it is simply a matter of promoting free markets and laissez-faire economics within the context of permissive governments that allow the magic of the marketplace and the invisible hand of market prices to guide resource allocation and stimulate economic development (Todaro, 1994:86).

A further cornerstone of this thinking is that market liberalisation draws additional domestic and foreign investment, and thus increases the rate of capital accumulation. According to traditional neoclassical growth theory, output growth results from one or more of three factors: increases in labour quantity and quality (through population growth and education), increases in capital (through saving and investment), and improvements in technology (Todaro & Smith, 2006:122). Closed economies (those with no external activities) with lower saving rates (other things being equal) grow more slowly in the short run than those with high savings rates and tend to converge to lower per capita income levels. Open economies, however, experience income convergence at higher levels as capital flows from rich countries to poor countries where capital-labour ratios are lower and thus returns on investments are higher (Todaro, 1994:86).

The neoclassical challenge to the prevailing development orthodoxy can be divided into three component approaches: the free-market approach, the public choice (or new political economy) approach, and the market-friendly approach.

### **2.6.1 Free market analysis**

Free market analysis argues that markets alone are efficient, and that product markets provide the best signals for investments in new activities; labour markets respond to these new industries in appropriate ways. Producers know best what to produce and how to produce it efficiently. In a free market, product and factor prices reflect accurate scarcity values of goods and resources now and in the future. The model further argues that competition is effective, if not perfect, and technology is freely available and nearly costless to absorb. Information is also perfect and nearly costless to obtain. Under these circumstances, any government intervention in the economy is, by definition, distortionary and counterproductive. Free-market development economists have tended to assume that developing world markets are efficient and that whatever imperfections exist are of little consequence (Taylor, 1997:145-152).

### **2.6.2 Public-choice theory**

Public-choice theory, also known as the new political economy approach, goes even further to argue that governments can do nothing right. This is because public-choice theory assumes that politicians, bureaucrats, citizens, and states act solely from a self-interest perspective. These individuals use their power and the authority of government for their own selfish ends. Citizens use political influence to obtain special benefits from government policies (e.g. import licenses or rationed foreign exchange) that restrict access to important resources. Politicians use government resources to consolidate and maintain positions of power and authority. Bureaucrats and public officials use their positions to extract bribes from rent-seeking citizens and to operate protected businesses on the side. Finally, states use their power to confiscate private property from individuals. The net result is not only a misallocation of resources but also a general reduction in individual freedoms. The conclusion, therefore, is that minimal government is the best government (Grindle & Thomas, 1991:154).

### **2.6.3 The market-friendly approach**

The market-friendly approach is the most recent variant on the neoclassical counterrevolution. It is associated principally with the writings of the World Bank and its economists, many of whom were more in the free-market and public choice camps during the 1980s. This approach recognizes that there are many imperfections in least developed countries' product and factor markets and that governments do have a key role to play in facilitating the operation of markets through non-selective (market friendly) interventions. These interventions could be by investing in physical and social infrastructure, health care facilities, and educational institutions and by providing a suitable climate for private enterprise (World Bank, 1990:145).

The market-friendly approach differs from the free-market and public-choice schools of thought by accepting the notion that market failures are more widespread in developing countries in areas such as investment coordination and environmental outcomes (World Bank, 1990:145).

## **2.7 SUMMARY AND CONCLUSION**

Over the years there have been competing theories which provide an understanding of economic development. Each approach has its strengths and weaknesses. The fact that there exist so many different ideological, theoretical, or empirical viewpoints makes the study of economic development both challenging and exciting. The term economic development could mean different things to different people; its understanding can even differ among countries. Economic development has traditionally meant the capacity of a national economy, whose initial condition has been more or less static for a long time, to generate and sustain an annual increase in its gross national product. Economic development can also be defined as the sustainable increase in living standards of the residents of a country.

There is a continual evolving pattern of insights and understandings that together provide the basis for examining the possibilities of contemporary development of the diverse nations. The linear stages model emphasises the role that saving and investment plays in promoting sustainable long-run growth. The Lewis two-sector

model of structural change underlines the importance of attempting to analyse the many linkages between traditional agriculture and modern industry. The empirical research of Chenery and his associates attempts to document precisely how economies undergo structural change while identifying the numeric values of key economic parameters involved in that process. Lewis' model was based on the assumption that many least developed countries had dual economies with both a traditional agricultural sector and a modern industrial sector. The traditional agricultural sector was assumed to be of a subsistence nature characterised by low productivity, low incomes, low savings and considerable underemployment. The industrial sector was assumed to be technologically advanced with high levels of investment operating in an urban environment. Lewis suggested that the modern industrial sector would attract workers from the rural areas. Structural change models hypothesise that development is an identifiable process of growth and change whose main features are similar in all countries. However, the model recognises that differences can arise among countries in the pace and patterns of development, depending on their particular set of circumstances.

The proponents of international-dependence theories argue the importance of the structure and workings of the world economy and the many ways in which decisions made in the developed world can affect the lives of millions of people in the developing world. International dependence theories have their origins in developing countries and view obstacles to development as being primarily external in nature, rather than internal. There is also the neoclassical counterrevolution, which favoured the privatisation of public corporations in developed nations and also called for the dismantling of public ownership and government regulation of economic activities in developing countries. The central argument of the neoclassical counterrevolution is that underdevelopment results from poor resource allocation due to incorrect pricing policies and too much state intervention by overly active developing-nation governments.

Each of these approaches to economic development provides some basis for understanding economic thought and decision making relating to economic development. The different perspectives will provide guidelines and a source for



information in later chapters when the study seeks solutions to a wide range of problems such as poverty, local economic development, unemployment, etc, within the demography of the study.