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9. ABSTRACT
Outlines alternative modes of economic development. As a result of the increase in scientific activity and communication about economic development in the post-war period in the West, it is useful to discern two main modes of viewing development, as well as on additional derivative mode. One of them is the conventional (traditional, neoclassical, orthodox, economic) approach. The second is the political economy (radical, non-conventional) approach. The third mode, which is emerging from the orthodox approach and the political economy approach, is termed the "growth and equity" model. These models, or "paradigms" are compared in the following aspects: 1) implicit value assumptions; 2) operational criterion provided for attaining the good life and the good society; 3) general methodology incorporated; and 4) strategies in attacking the problem of economic development. The "growth with equity" strategy rejects the traditional capitalist, revolutionary socialist, and neo-Malthusian views of development. It argues that the capitalist approach does not trickle down to the poor, revolutions are not likely in most LDCs, and that people have the wit and will to come up with new approaches to overcome the problems facing humanity today. But the new strategy does draw from all three of the existing visions in the world. It employs the capitalist institutions from the traditional approach, borrows the egalitarianism of the socialist approach, and embodies some of the ideas of the neo-Malthusians. Advocates of this strategy are convinced that there are limits to growth, and there really are ecological constraints facing us. Six models of this approach are discussed: Employment Generation/Appropriate Technology; Redirecting Investment; Meeting Basic Needs; Human Resource Development; Agricultural and Rural Development; and New International Economic Order.

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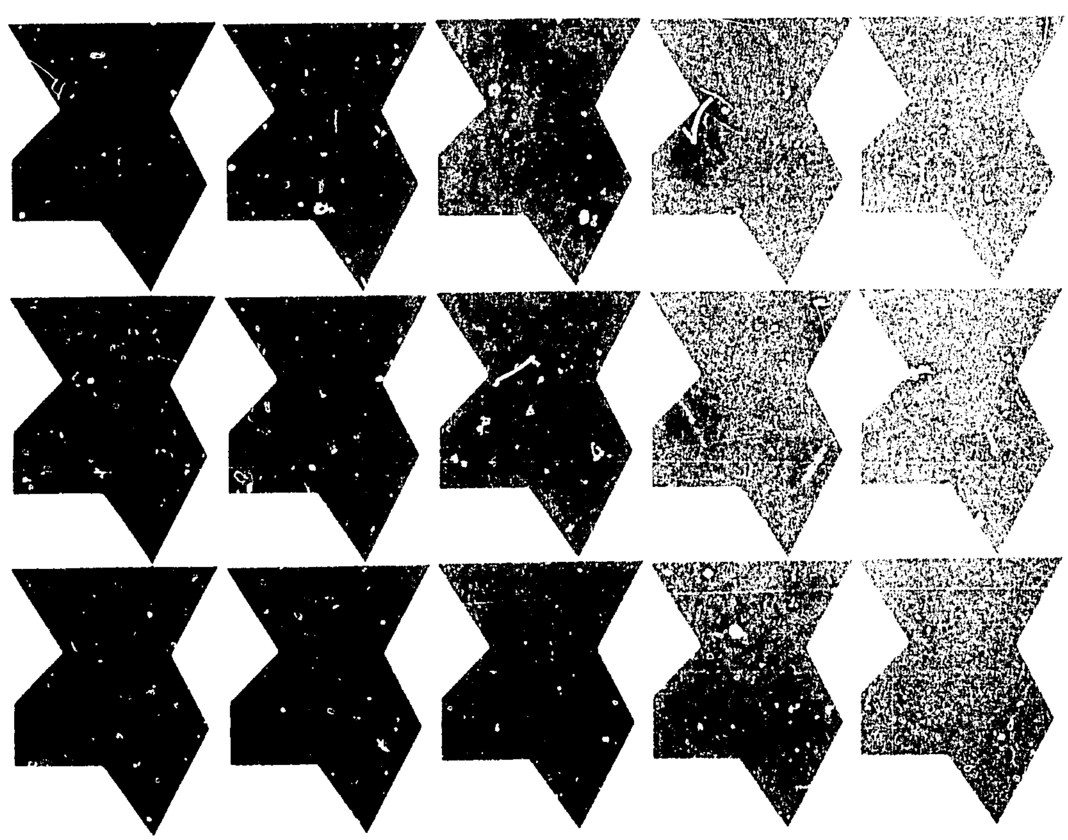

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DSP OCCASIONAL PAPER No. 3

ECONOMIC DEVELOPMENT:
COMPETING PARADIGMS - COMPETING PARABLES

by

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Thanks are due to the many participants in the Development Studies Program and The Administrator's Development Seminar who sat through much rougher formulations of our ideas than are contained here. We are grateful to Charles K. Wilber and Richard Blue for their contributions to this monograph. This paper reflects our views and not necessarily the views of the Agency for International Development.

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DSP OCCASIONAL PAPERS: an introduction

The Development Studies Program was established in 1975 to help improve the capability of this Agency to carry out the new emphasis on rural development in our legislation. Over 200 AID officers have gone through the program and many more will be reached in future sessions.

Our purpose is to stimulate and continue a dialogue on how better to do our job of improving the quality of life of the rural poor in the developing countries.

One way in which the DSP will help with this task is by circulating a series of Occasional Papers which grow out of the program. These Papers will include the work of the participants, faculty and outside speakers who contribute to the program. They will be circulated to former participants and others who are interested in the development process.

We welcome your comments, suggestions and contributions to the series.

Richard N. Blue
Director
Development Studies Program

Concern with economic development is certainly no new phenomenon. In the book which celebrated its bicentennial along with that of the United States, The Wealth of Nations, Adam Smith made clear that his leading theme was to be "economic development". The theme has continued to concern theorists during most of that 200 years.

What is new at this point in time is that, as a result of the increase in scientific activity and communication about economic development in the post-war period in the West, it now becomes useful to discern two main modes of viewing development, as well as one additional derivative mode. One of them we will term the conventional approach, or alternately traditional, neoclassical, orthodox, or economic approach. This approach began with Adam Smith and was built on by Ricardo, Mill, Marshall, Schumpeter and Keynes; and in our own day by Arthur Lewis, Ragnar Nurkse, Albert Hirschman, et.al.

The second approach we will term political economy or alternately radical or non-conventional. This approach begins with Marx and includes Marxists such as Lenin, Mao, Paul Baran, and Andre Gunder Frank. It also includes the Latin American dependency school of writers such as Celso Furtado, Osvaldo Sunkel, and Teotonio Dos Santos. Finally, in this category, we will place the liberationists such as Ivan Illich, Denis Goulet, and Paolo Freire. We will return to the specific writings later in the treatment. (The bibliography contains a full citation of the relevant works of the authors cited throughout.)

The third mode, which is emerging from the orthodox approach, and to some extent from the political economy approach, is what is termed the "growth and equity" model. There are already a number of variants coming from writers such as Jim Grant, Mahbub ul Haq, John Mellor, Albert Waterston, Irma Adelman, Paul Streeten, and others.

There are a wide variety of data which we might use in distinguishing the approaches: the writings of the various schools, the policy proposals which each makes, the types of "models" which each draws upon in its analysis. We will have to use all of these sources, and in doing so, we will find a bewildering array of material to deal with, some of it inconsistent or very contradictory, and much of it not completely fitting into the categories which we suggest. To paraphrase Dostoyevsky: "(Economic development) is a terrible and an awful thing. It is terrible because it has not been fathomed, for God sets us nothing but riddles. Here the boundaries meet and all contradictions exist side by side." (The Brothers Karamazov). It is our task to bring as much sense to the area as we can.

In our efforts to order the information, it will help us to draw upon the construct of a "paradigm" as suggested by Thomas Kuhn. While there are many meanings to the term, the most useful for our purposes suggests that a paradigm is a world-view shared by a group working on or thinking about a particular topic, e.g. economic development. Such a world-view affects their activity across the board: the questions which are asked, the information which is collected, the method of interpretation of that information, and even the group with whom there will be communication about the questions. Because of the functioning of this world-view and this scientific community, advances in knowledge about the particular concerns of this community are facilitated; but it is very difficult to move from one world-view or one community to another.

As long as the paradigm relates successfully to the questions addressed, there is substantial "progress" in understanding and knowledge. On the other hand, even when the questions are not addressed with a high degree of success, when there is a "crisis" in the community, members of the community continue to follow the paradigm's guidelines rather than breaking with that world-view and adopting another. Only with a "scientific revolution" will such a shift occur. An example might help.

Kuhn provides a number of examples of scientific crises and resultant revolutions, most of them drawn from the physical sciences. For example, we find that Newtonian physics had a major impact on the understanding of physical phenomena. It was able to explain the motion of the planets in a highly successful manner, even pointing out why, in certain respects, the moon failed to behave as might be expected. It was able to organize and explain a series of scattered observations on pendulums and on tides. It could be adapted to explain the speed of sound in air. In addition, later work verified many aspects of the theory which had not been testable in Newton's time. Thus, a scientific community grew up using and developing this paradigm. But by the nineteenth century, the effort to explain the propagation of light raised questions about Newton's theory, and these questions were answered by adding an entirely new construct, "ether," which was claimed to be a medium for light. By the end of the century, experiments designed to verify the existence of ether were negative. Yet, Newtonian physicists continued investigating like Newtonian physicists. It remained to Albert Einstein to resolve many of these anomalous results by propounding his theory of relativity. With this, there was suggested an entirely new world-view which came to build up its own community and its own methods of investigation. Some Newtonian physicists could adapt to the new paradigm; others remained Newtonian thinkers until their death. But the crucial point is that the development of this new paradigm inculcated an entirely different manner of looking at the world, of investigating it, of existing within it. An old paradigm had been rather completely supplanted by a new paradigm, an old world-view by a new one.

While the inability to develop crucial experiments makes this process unlikely in the area of economic development, the general construct of a "paradigm" will be useful in distinguishing between the conventional and the political economy approaches, our competing paradigms or world views.

We will focus on four aspects of these paradigms for the comparison to be made between them.

1. What are the value assumptions implicit in each paradigm? Implicit in every social theory are certain assumptions which color the particular stance taken. Three of these are most useful in differentiating our paradigms: assumptions about human nature; assumptions about the good life; and finally, assumptions about the good society.

2. What operational criterion does the paradigm provide for attaining the good life and the good society? Efforts to make the above ideals reality must be guided by certain relatively recognizable criteria which can suggest whether the efforts are likely to succeed or not.

3. What is the general methodology incorporated in each paradigm? We will find that both contain a theory of underdevelopment and a theory of development and that the particular approaches differ substantially in their content and in their degree of refinement.

4. What strategies are suggested in attacking the problem of economic development? Here the paradigms are strikingly different, for it is here that the world-view must become a guide for action.

In carrying out the comparison, we will begin with the conventional paradigm. The treatment of the political economy paradigm will follow, and growth and equity will comprise the final section of the paper.

I. The Orthodox Paradigm

This approach to the problem of economic development has a long history as noted above and it has long been the dominant paradigm of Western economists, providing a world-view which seems coherent and insightful into the questions of economic development.

i. The Assumptions

The basic unexamined assumptions are familiar to anyone who has been exposed to the neo-classical model of the functioning of an economic system. As a starting point, man is held to be a rational animal, with each individual knowing his or her own self-interest and acting individually in such a fashion as best to attain that self-interest. In this context, the role of economics is to provide better information on economic conditions and on the technical constraints faced by the individual so that the process can be facilitated.

What is the good life? To a traditional economist, the good life is based on the notion that people are hedonists. They want to maximize their pleasure and minimize their pain; or as economists put it, they want to maximize utility and minimize disutility. What brings pleasure? The answer is consumption: consumption by individuals of marketed goods and services. Since people are hedonists, their wants are insatiable. Someone wants a bicycle. He gets a bicycle and immediately starts thinking about a car; he gets a car and immediately starts thinking about an airplane. There is absolutely no limit to wants.

What brings pain? Pain comes from work, so work is seen as a disutility, a painful process.

We can see now that the good life is one which allows one to maximize consumption of goods and services with the minimum effort, with the minumum work. If we combine this basic goal with the rationality assumed above, we end up with the traditional theory's "economic man". We see men as economic men, primarily motivated to consume, with minimum effort, and using their rationality to attain that end.

The third question is, what is the good society? The answer to that follows from the notion of the good life. The good society is one in which people have the most possible goods and services with the least cost, the least effort. But immediately we come up with a problem. Resources are limited. We only have so much oil, so much coal. If we combine limited resources with insatiable wants, the result is scarcity. In addition, we have a limited capacity at any time to produce goods and services, for we have only so many factories and laborers, a fact which again puts a limit on output and again results in scarcity when confronted with insatiable wants.

Traditional economics views scarcity as its particular concern, treating it as <u>the</u> economic problem. Given competing wants and limited production possibilities at a given time, economics sets itself the task of deciding how to allocate these scarce resources among the competing or alternative ends, and the good society must be successful in this allocation problem.

In a more tangible form, traditional economists posit three economic characteristics of a good society. First of all, it should be characterized by consumer sovereignty. Sovereignty means power, and if consumers have sovereignty, they have the power to determine what is produced. They choose to purchase the goods and services that they want most, and that is what the society produces.

The second characteristic is efficiency. Efficiency in economic terms simply means attaining the maximum output with given input. If the economy operates efficiently, it will allow production of the greatest amount of output possible with the given amounts of scarce resources. As a result, the society's members will have the greatest opportunity to indulge their hedonistic desires. Thus, this is an important characteristic of a good society.

The third attribute is stability. The good economic society should not be characterized by booms and depressions, by prosperity and poverty, by feast and famine. Rather it should provide a stable level of goods to its consumers, thereby allowing them reasonable expectations about their possibilities for consumption.

A society which exhibits these three characteristics is one which merits being termed "the good society." Of course, this does not imply that scarcity is removed under these conditions, for it will always be with us. But what is implied is that the society is doing the best that it can within the bounds of its constraints; and that is all that can be asked of it.

It is from these assumptions or views that the traditional paradigm originated. We will find that very different assumptions characterize the political economy paradigm.

ii. Criterion

Let us turn now to the second differentiating factor, the operational criterion for attaining the good life or the good society. It is here that the concept of "economic development" enters. A society is undergoing a process of economic development in the degree to which it is moving to attain the good life for its members, and the good society for all of them. In the traditional paradigm, the operational criterion is quite simple: development is occurring when a society attains the highest rate of growth of output (GNP) possible. Thus, over time, a society, which is undergoing rapid growth of output without violating the characteristics of the good society, is one which is developing. This should seem logical, for it is such a society which can best satisfy its members' desires for more goods. As a result, the goal of economic development theory must be to provide insight into how this growth might be accelerated; and as we turn to the methodology of this paradigm, we will begin to examine the insights of traditional economists into solving this problem.

iii. The Methodology

Both of the paradigms contain within them a theory of under-development and a theory of development, and it will help to distinguish between them. Although it might seem to reverse the usual order, in the orthodox case it is best to begin with the theory of development, for it is the more developed portion of the orthodox paradigm. In that theory of development, two factors and their functioning are of the greatest significance. These are: first, the productive resources at the disposal of society; and second, the institutions developed to guide the use of these resources.

To begin with the resources, the quantity of output a firm or a system generates depends of the quantity and the quality of the inputs into production. This can be summarized in a "production function" written as follows: Q=F(K, L, NR, T, En) where:

Q is the output of goods and services in a given period of time;

K is the amount of capital or machinery used in production;

L is the input of labor into production; .

NR are the natural resources used in production, most particularly land;

T is a measure of technical change in the production process;

En is some indicator of entrepreneurial activity; and

F ( ) represents the idea of a functional relation which simply means that if any one of the inputs (K, L, etc.) increase, output will also rise by a given quantity. Let us look specifically at each of these inputs.

When Adam Smith looked at this question 200 years ago in The Wealth of Nations, he found that labor was the key input. He argued that output is a function of the quantity and the quality of the labor force. In addition, he put particular emphasis on the way labor is organized through his famous example of the pin factory.*

* To some degree, modern economists might treat the organizational questions under entrepreneurship or even technical change. We keep Smith's construct by including them in the focus on labor.

He observed a pin factory and noticed that one person cut the wire, another person put the head on, another person stuck them in the paper, and so on. He found that the plant was producing about 4,800 pins per worker per day. But when each worker made a pin by himself, cut the wire, put the head on, stuck it in the paper, etc., he made only 20 pins per day. So Smith concluded that the key to increasing output was specialization and division of labor. With specialized labor, each person doing one small part of the task, far greater output is attainable. Harvey Leibenstein (1966) -- x-efficiency; and Albert Hirschman -- machine paced production; have suggested additional factors internal to the firm's organization of work which can increase the output from a given amount of labor. Thus, such changes and increased specialization of labor are means of affecting output. The second and most obvious way to increase output is through changes in the quantity of labor input. By increasing employed labor, measured perhaps by the number of man-hours expended in production, output can be increased. Finally, if the basic quality of labor could be enhanced by improving its physical capabilities or its mental abilities, once again output would be increased. Taking this strain of thought from Smith, modern theorists of the human capital school of orthodox economics have suggested that developing countries should concentrate their efforts in this area. Frederick Harbison and Theodore Schultz (1963) have suggested programs, mainly educational, to improve the quality of the labor input.

The second thing that Smith emphasized as a factor of production was capital. For production to take place, there must be capital for labor to work with. The Industrial Revolution was essentially an energy revolution -- a revolution in the source of energy for production. Production no longer relied solely on animate energy such as people, horses and oxen, but began to rely much more heavily on inanimate energy, i.e., water power, steam, coal, petroleum, and nuclear energy. But to turn out output or to be transformed into useful work, this energy must be applied to machinery. Thus capital formation occupies a central place in the orthodox theory.

For the economist, physical capital is man-made goods used to produce other goods. It is a good that was produced, and rather than being consumed immediately, it is used to produce other goods. In order to build this capital, there must be factories, so industrialization becomes the key. Traditional economists will often go so far as to argue that development equals industrialization, that the two processes are synonymous. Such a claim is based on the observation that the rich countries in the world are industrialized countries.*

In order to build capital, a society has to save, it has to forego consumption today and to put it into steel mills, power plants, textile mills, etc. According to traditional theory, who provides these necessary savings in poor countries? Do the landlords save? No, the landlords are wasteful and profligate, for they spend their money on conspicuous consumption. Do the workers save? No. The workers don't save for the workers get only subsistence incomes. They just barely subsist. So, who can save? Only the capitalists can! So the capitalists, the owners of the capital goods, are the source of savings. An implication of this view is that in order to industrialize and to grow, in order to develop, income should be redistributed to the capitalists. The capitalists will save, they will reinvest, they will produce more capital; this will lead

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* The oil rich countries are obvious exceptions.

to further industrialization, and to further transformation of energy into output.

Theorists who take this starting point suggest that development will come about if profits can be increased, for that increases capitalists' income which will lead to increased savings, which will lead to increased investment in capital goods, which will lead to industrialization - which equals development.

One representative expression of these views was that of Mahbub ul Haq in his 1963 book. He said:

> It is well to recognize that economic growth is a brutal sordid process. It would be unfortunate, however, if this change in policy emphasis (away from growth) in the developed countries were to spill over, consciously or unconsciously, into the growth philosophy of economies still in a stage of "take-off." In this latter stage, the best (and, perhaps, the only) form of social security is a rapid extension of productive employment opportunities to all through the creation of sufficient capital by some. There exists, therefore, a functional justification for inequality of income if this raises production for all and not consumption for a few. The road to eventual equalities may inevitably lie through initial inequalities.

This emphasis on capital has characterized the work of a large number of post-war development economists. In different form it is the basic point of Arthur Lewis, Paul Rosenstein-Rodan, Ragnar Nurkse, Harvey Leibenstein, Gustav Ranis, John Fei, and many others. They all emphasize that capital is the key and the problem of development is to build capital. Development means using increasing quantities of capital per worker, so that the society can be more productive, and can get more output than by using labor alone. The constraint of scarcity is relaxed in this fashion.

The third factor of production which has received emphasis is land, along with other natural resources. Physiocrats at the time of Smith argued that land is the source of growth, of greater output, and that efforts have to concentrate on the land. Their modern-day disciples who draw upon this strain of thought are theorists such as Bruce Johnston, John Mellor, Carl Eicher, and Theodore Schultz (1964). They don't deny that a country has to industrialize, and they would agree that development and industrialization are related. But in order to industrialize, agricultural development must first be stimulated.

Agriculture makes four contributions to development. First, agriculture has to provide surplus food. It is essential to produce enough food (wage goods) to feed the workers who are going to leave the farms and go into the factories to produce the steel, to drill the oil wells, and so on. So there must be a surplus of food coming out of the agricultural sector.

Secondly, the agricultural sector must contribute its surplus labor, that labor which is not contributing to agricultural output. The people must be taken off the farms and put into the factories where they will be more productive and will produce more goods.

Third, agriculture or natural resource extraction must provide surplus output to be exported in order to allow the import of the capital goods that are needed and can't be produced at home. Agriculture has to provide an export surplus.

The fourth role for the agricultural sector is to provide a market for industrial production. Specialization in industry requires a market for industrial output, and the agriculture sector must constitute a major portion of that domestic market. This is especially true given the dominant role of agriculture in any country beginning the development process.

How can agriculture successfully play these four roles? It should be apparent that one crucial aspect is to increase the productivity of the agricultural sector. The key to this, according to traditional economics, is to use more capital. Just as it is necessary to use more capital in industry, there must be more capital in agriculture, with its implied shift from animal power to inanimate energy. This means more and more capital-intensive agriculture, and generally it means larger and larger farms with more and more output per worker. United States agriculture has carried this furthest: four percent of the labor force produces enough food for the whole population, plus a considerable amount for export. This is the pattern suggested for agriculture, and a similar pattern of capitalization is suggested for natural resource industries.

As can be seen, industrialization and agricultural development occur almost simultaneously in this view. Farmers leave the rural area; in essence they carry the food to feed themselves to the industrial sector, where their activity now results in increased industrial output which is sold to workers and farmers. This whole process is facilitated by increasing productivity in agriculture. Careful analysis of the conditions under which this process leads to development has been carried out by Arthur Lewis, by Gustav Ranis and John Fei, and in a more technical but more flexible manner by Allan Kelley <u>et. al.</u>

The next input into production was not separately emphasized by Adam Smith, as concern with the role of technology or technical change is a modern development, first pressed by Joseph Schumpeter and by Thorstein Veblen. Technology is the way of producing things, the way we combine the inputs. Technology includes not only our tools, but our organization and our knowledge of how to produce. The modern-day disciples of Schumpeter and Veblen -- such people as Robert Solow at MIT -- also place a great deal of importance on technical change. Solow did a study of U.S.

output growth during the 20th century, and argued that one could only partially explain the increase in U.S. output by looking at increases in the quantity of inputs of the factors of labor and capital. The other part of the increase was explained by the introduction of new technology. This is essentially the same conclusion reached by Edward Denison at Brookings, and Moses Abramovitz at Stanford, while Angus Maddison has done a similar study of developing countries. All find that technical change is central to growth, for it is not possible to explain increased output by simply looking at the labor used or the increase in capital. As a result, many traditional economists today emphasize technology transfer to underdeveloped countries as the key to their development.

The final input into production is entrepreneurship, and once again Smith did not fully elaborate the role of the entrepreneur. This was left to Schumpeter who specified two roles for the entrepreneur. First of all, he is an innovator who creates new ways of doing things. In the process he destroys the old way and initiates a process which will replace that old way with an innovation which is organizationally more successful. He is also able to amass the capital necessary for this undertaking, while others cannot succeed in this basic step. His second role is as a want creator. He is able to create new tastes and wants and thereby to increase the market for his product.*

The entrepreneur par excellence was Henry Ford: the man who convinced us we all wanted a car and who came up with the assembly line method of production on a large-scale, i.e., an entirely new way to produce

* It should be noted that this role suggests that entrepreneurs affect the demand for products by creating these wants. In our previous treatment, charges in amounts of factor inputs affected the supply of products.

those cars. He also was able to amass the funds necessary despite the disdain of the major banking groups such as J. P. Morgan. The entrepreneur, according to Schumpeter, was a social deviant, an outsider in some way. He is the Samurai in Japan or the Protestant in Catholic Europe. He is a risk-taker, one who wants to engage in what Schumpeter called "creative destruction" by doing away with the old way of doing things and creating new ones. He wants power and hopes to establish a dynasty. In order for the entrepreneur to be successful, the government has to encourage him and has to provide an environment which is conducive to entrepreneurship.

A number of contemporary theorists have followed Schumpeter in emphasizing entrepreneurship and have attempted to measure empirically factors which determine entrepreneurial activity. In this vein might be mentioned Everett Hagen's work on the "antioqueños" of Colombia, and David McLelland's work on "n-achievement."

To recapitulate. Orthodox economists argue that output is a function of the quantity and quality of labor and of capital, the amount of land and other natural resources, the kind of technology, and the kind of entrepreneurship. All these different theorists mentioned above and cited in the bibliography emphasize different factors; but they would all acknowledge that all these resources are important. This viewpoint is the basic building block of the orthodox paradigm and its methodology.

Before turning to orthodoxy's model, the implicit "theory of underdevelopment" should be specified. In most cases this is a secondary aspect of the conventional approach which is concerned much more with the conditions for growth. As a result, many approaches to explaining underdevelopment simply suggest that one or more of the constituents necessary for growth are missing or are inoperable. There are a number of different approaches to making this point and we will briefly describe the main ones.

--Obstacles to growth: in this view, countries are underdeveloped because their economies contain any one of a variety of obstacles to growth. Among these obstacles are: climate, culture, natural resource endowment, genetic strains in people or in animals or food crops, etc. The common characteristics of these factors is their resistance to any efforts to change them.

--Missing factors: another approach suggests that some key aspect in the growth process is missing. The most common "missing factor" is entrepreneurship, but others are a functioning market system, the existence of capitalist firm behavior, the necessary quality of labor or of land, the required savings rate, etc. This is very similar to the obstacle approach, though here the avenue to development is open if these factors are supplied through domestic or international efforts.

--Vicious circles: the actual functioning of the economy is at fault in this view. Nurkse, for example, suggests that in poor countries, people have very little to save over their subsistence income. But these low savings imply low investment, and low investment implies low growth; but if growth does not occur, savings cannot be raised so we end up in a vicious circle, though one which could be broken by an infusion of external funds.

--Lower level equilibrium: these are basically mathematical models which derive the characteristics of an economy in equilibrium. Under certain specification, they can generate an equilibrium for an economy at a low level of per-capita income. It also turns out that efforts to move the economy from that equilibrium will generally be unsuccessful unless they are absolutely massive, for there is always a tendency for the economy to fall back into that low-level equilibrium. Nelson derived such a model relating savings and investment. Leibenstein (1957) related population growth and investment in a type of "neo-malthusian" approach. The key result again is that partial measures will not succeed; some massive changes are required.

--Slow growth: the final theories are again highly mathematical and derive the conditions for continuous growth in labor, capital, output and per-capita output. (Solow (1956), Swan). Under certain circumstances, most notably the absence of technical change or of improvements in the quality of labor or capital, per capita income can remain virtually unchanged though labor, capital and output are all growing. Thus without changes in these areas, growth in output per person will not occur.

With these main "theories" of underdevelopment and the view of development which is implicit in the basic framework of the traditional paradigm, we come now to our fourth question: what model is suggested to foster development or growth?

II. Capitalist Model

Let us now turn to the capitalist model of development and examine the institutions and strategies.

What are the institutions required for development? How can the economic factors be combined so as to obtain maximum economic growth? We turn now to the institutions in the capitalist economy and we find that there are four institutions which play important roles.

The first institution is private ownership of the means of production. Everything is owned privately -- capital, land, technology, and so on. With individual ownership, it is the private owners who decide how to use the factors of production. Since they are all rational economic men, they will use them in the fashion that will bring them the greatest benefit. We will see later than Smithian doctrine implies that society will benefit from this private ownership and use as well.

The second institution of importance is the market, or better put, the market system, with interrelated markets for factors of production and for output. We can well examine these various markets separately.

--Labor Market: In a modern economy, labor becomes a commodity to be bought and sold in the market, just like books or Pepsi Colas. People sell their labor wherever they can get the highest wage. That was not true in a feudal society. In a feudal society, a person decided what job to undertake in a very simple manner: he did what his father or mother had done before. There wasn't a labor market in a traditional, feudal society. So the labor market is a new institution which comes about with industrial revolution, and which is necessary for development to occur in a capitalist system.

--Land Market: With industrialization and the development of a capitalist economy, land becomes a commodity too. All of nature, in fact, becomes a commodity, to be bought and sold, to be used for whatever purpose is most profitable. How does the owner of land use it? Being a rational hedonist, he decides among alternatives and chooses that one which is most profitable. We should note that this is very different from the situation in a feudal society. As with labor, decisions on the use of land were made on the basis of tradition. The holder of the land did exactly what he did last year and what had been done before that. Thus, there was no market for land in a feudal society, and land wasn't bought and sold since it was owned by a particular social group and was used for traditional purposes.

--Capital Market: The final major input with a market is capital. We discussed capital in a physical sense, i.e., machinery used in production of other machinery or of output. We also have to talk about financial capital, that is, money. Generally financial development is seen as important in facilitating the savings -- investment process of capital formation, though writers such as Friedman give it a much more central role. Both financial capital and physical capital are bought and sold in markets, and again the basis is to use them wherever they return the greatest profit. Thus, once again, owners of capital act rationally, making their decisions based on profitability. One theory of development (Shaw) gives center stage to the growth of financial intermediaries and a resultant increase in the efficiency of operation of the economy.

Before moving on to the last market, it should be noted that the operation of the factor markets noted above jointly generate one major result: that each factor when used in its most profitable pursuit earns a return according to its contribution to increased output. Economists call this contribution its "marginal product" and term this "marginal product factor pricing." The importance of this result is that it tells us how income is distributed and why. We know that labor, land-owners, and capitalists get paid according to their contributions. Payment to entrepreneurs and to technology are tied in with payment to capital, and the upshot is that the functioning of markets determines the distribution of income between laborers, capitalists, landowners -- the "functional distribution of income."

--Output Market: We call this the market for commodities. Since no single person can -- or should -- produce all he wants, he must purchase goods in the commodity market. Food, clothing, shelter, etc. are obtained here, and it is the demand of consumers for these goods that determines the amount of resources which will be dedicated to their production. Thus, indeed, consumer sovereignty exists.

The third crucial institution is the capitalist firm. It is here that production takes place, that all of the privately owned resources are brought together and made to cooperate in such a way as to produce the output the factory owner chooses. In order to produce most profitably, capitalist firms generally have adopted particular organizational structures. First of all, they develop as far as possible the specialization and division of labor. This is seen most clearly on production lines, but any firm will basically follow this pattern. Firms also have found that it is most profitable to organize in a hierarchical fashion. Thus the capitalist firm is organized in the form of a pyramid, with the owners at the top. They choose and supervise the top managers, who supervise five or six people, who then each supervise other people, etc. It is organized in a hierarchical and bureaucratic fashion. Thus there is constant monitoring of performance at all levels. In addition, there are rules, there are norms, and activity occurs according to them. Thus workers don't decide each day what they are going to do or what time they are going to start to work. Such procedures are routinized and guided by rules which change only slowly, if at all. The ability of such firms to operate profitably has made them very important institutions in capitalist economies.

The final institution -- and the key to capitalist development -- builds upon Adam Smith's concern with specialization and extends its implications into the need for unrestricted trade at local, national, international levels.

Returning to Smith's concern with individual laborers, if each worker specializes and produces only a small part of a product, he will become more efficient and more productive. But he will also become more interdependent and will lose his self-sufficiency. Since he will have produced a surplus of pins by the end of the day, he will have to be able to sell them, so he needs a market for these pins.

So for specialization to work, workers will have to be able to sell the excess of their production over their needs in some market. It follows that the bigger the market, the better; for then specialization can be carried much further, with each worker specializing in one task all day long and trading his surplus for the products of other specialized laborers. Some people are good carpenters, some are good plumbers, some are good electricians. It makes sense to specialize and to trade with each other. This of course goes for firms which group together a number of workers.

Smith argued that the same is true for whole regions or countries. There are regions that have advantages in particular types of production. It makes sense for Florida to grow oranges and for New England to produce maple syrup. Such specialization increases the total amount of both goods. When oranges are exchanged for maple syrup, both regions can obtain more of the two goods than would be the case when both regions produced both goods for their own use.

Taking the analysis one step further, Smith argued that it also makes sense for nations to specialize. Each nation should specialize in producing those things in which it has the greatest advantage and then there should be trade among nations. As a result of trade, every nation will be better off than it would be if it tried to produce all its own goods.

For example, at the time that Smith lived, the United Kingdom had a comparative advantage in the production of capital goods (machinery) since it was the first country to industrialize. The South of the United States had a comparative advantage in cotton, and therefore sent cotton from the South to the United Kingdom; and the UK sent capital goods to the Northeast of the U.S., to New England. Then New England sent textiles and other finished consumer goods South. So there emerged a three-way trade, with each part specialized in what it did best. Partly as a result of this specialization and efficient operation, economic development took place in the U.S. and the U.K.

International trade is a very important element in the traditional economic paradigm, for it expands the market so a firm or a country can specialize to the maximum and sell to the whole world. In fact, the theory implies that world-wide free trade will lead to maximum efficiency, so that every country should specialize. From this free trade, all parties will benefit and there will be a move toward world-wide equalization of wages for labor, of rent for land, and of the return on capital. This aspect of the theory is known as the Hecksher-Ohlin Theorem.

International trade is seen as the engine of growth. With trade, and specialization, there will be growth and development. This was true in the case of England, New England, Japan, Hong Kong, Taiwan, Korea. Other orthodox theorists have taken this strain of Smith's thought and suggest that developing countries adopt free trade as a means of development. Thus theorists like Jacob Viner, Gottfried Haberler, and Milton Friedman argue in favor of specialization according to comparative advantage in underdeveloped countries today and in favor of free trade policies in these countries.

Fitting these institutions together allows us to see how the system works. People own land, labor, or capital. They take their labor, or their land, or their capital into the market and they sell it to a capitalist firm. From that sale of a factor of production, they get an income. With their income they go into commodity markets to buy the goods and services they require. The firm then uses the revenues they obtain from selling commodities to buy more land, labor, etc. Thus, the system is closed.

Given such a system, the question remains as to what can be done to encourage development, what strategy should be used. Suggested strategies have changed over time. Let us examine the earliest.

i. Development Strategy: Laissez-Faire

At the time of Smith, and through his influence, the policy activity of the government was clearly specified. Hands off. Laissez-faire. The French Finance Minister, Colbert, asked a businessman in France, "What do you want the government to do to help you?" The businessman said, "Laissez-nous faire." Leave us the hell alone! So in Adam Smith's approach, the strategy is for the government to do very little, for the actions of private individuals will bring about development, guided by an "invisible hand."

That doesn't mean that the government is to do nothing, however, for it has several definite roles. First of all, it must provide for law and order. Adam Smith said that what is needed for development to take place are two things: the acquisitive spirit and domestic tranquility. The first he solved by the assumption of rational economic man which implies that everybody is acquisitive. The second, to use John Mitchell's term, means that you have to have "law and order." For Smith, this implied a need to protect private property, to ensure the first of our economic institutions. Quoting now from Smith -- "to protect the rich against the poor, to protect those who have property against those who have none at all." This is one of government's jobs.

Another proper function of government is to enforce private contracts. If someone enters into a contract to sell his labor, he has to live up to it. A contract to sell land must also be fulfilled. By enforcing private contracts, the government prevents mere force and fraud and ensures that market transactions can be carried out, that markets do indeed function.

In addition, the government has certain positive roles to play. In general, it must provide those goods which society as a whole consumes but which a private firm could not produce and sell profitably to the individuals in society. The main such "collective good" is national defense. There is no way to exclude from its benefits someone who does not pay, so firms cannot earn a profit on providing national defense. This must be done by the central government using powers of taxation to spread the cost.

Finally, government must provide for a system of money and credit, whereby the people with entrepreneurial ability can get together with the people who have the money. Often the people who are entrepreneurs will not be the people with the money. Since entrepreneurial activity is central to development, government's proper role is to ensure that there is a money and banking system which allow them to obtain the needed funds.

In all of this, the emphasis is on providing a climate conducive to entrepreneurship. If government does just these things and leaves businessmen-entrepreneurs alone, the institutions emphasized by Smith will work. In particular, the government should avoid taxing entrepreneurs too heavily, for their actions and savings might be discouraged. The entrepreneurs will bring the resources together in order to make profits and development will take place as they reinvest their profits and output goes up.

In addition, it should be noted that this paradigm places fundamental importance on one indicator of the functioning of the economy: prices, for it is in price distortions that bad government policy or other institutional restraints on trade and market functioning will appear. Thus, it is often said that "getting prices right" is the key to development.

This is the orthodox parable, the lesson which should be learned by underdeveloped countries. England developed in this way, as did the United States. Economists such as Friedman, Haberler, Johnson, or Bauer would, to this day, suggest this as the most efficacious road to development.

But the post-war period raised a challenge to this view. If development will occur in this fashion, why haven't the underdeveloped countries developed? What has gone wrong? What can be done? This question stimulated a search for a strategy to overcome the obstacles or missing factors or low level equilibrium or low growth rate. With this we begin to add new elements to the old strategy.

By the mid 1950's, some development theorists began to have doubts. They began to wonder if everything was going to turn out right just by letting time pass. Many became pessimistic and lost confidence in laissez-faire, since it had obviously not worked. So a spate of theories of underdevelopment emerged to explain why laissez-faire wouldn't work in underdeveloped countries.

As noted above, all of the theories place great emphasis on the investment process. There were two main strains to these theories which led directly to a new strategy. The first of these was to point out the vicious circle or low level equilibrium aspect of underdevelopment. On the supply side, since people are poor, they don't save; and without savings, there is no investment and no growth. On the demand side, the poverty of the population means that there are no substantial markets for commodities and therefore there are few profitable alternatives to lead entrepreneurs into action. As Nurkse put it, "The curse of the poor is their poverty." Even if these vicious circles are attacked by ordinary means, the low level equilibrium influence will generally cause the economy to lapse back into its state of underdevelopment.

The second general theme is the failure of markets in these countries, the failure of one of the key institutions in the capitalist model of development. If markets don't operate well, then resources won't be used in the most profitable manner and output will suffer. These are claimed to affect the investment process adversely in three manners. The first of these is the inability of markets to take externalities into account.

Externalities, or external economies, are the unintended side effects of production or consumption for which the producer or consumer doesn't pay or for which he doesn't get compensated. Examine a consumer of a cigarette. He gets all the benefits, but his neighbors pay part of the cost. They breathe in the smoke. Or examine a factory which pollutes the air and makes an entire city's clothes dirty. That is a cost to all of the citizens, but the factory owner doesn't pay for it. These are examples of negative externalities. If someone has an orchard and his neighbor has a bee hive next to it, the bees come over and pollinate the trees, but the orchard owner doesn't pay for that. Thus he receives a positive externality.

In poor countries, economic undertakings have large positive externalities. Thus private investment is low because an individual entrepreneur can't capture these externalities -- it doesn't pay him to undertake the investment. Suppose someone builds a factory, and trains a skilled work force, spends money on them, helps them obtain skills. What do the workers do? They leave and go to work for somebody else who pays a higher wage but who didn't have to pay for any training costs. In light of this, there is no reason for an entrepreneur to spend money on training, since other capitalists will get all the benefits. So businessmen in poor countries underinvest because they can't capture the externalities; and underdevelopment persists.

Another complication for the market is that investment is lumpy. In order to build a steel mill, an entire integrated steel mill must be built, not part of a steel mill or a tiny steel mill. For an efficient steel mill must be of a certain minimum size which is generally beyond the capabilities of the individual entrepreneur in a poor country. Thus it doesn't get built.

The final problem for the market is the lack of social overhead capital. Poor countries don't have the roads, the schools, the airports, the dams, or the electrical generating plants needed for production and growth. Once again capitalists won't build them because of their large cost or their low initial profitability. Such social overhead capital must be provided by the government.

What strategy might be successful in face of these failures of the laissez-faire approach?

ii. Development Strategy: Planning

To overcome these problems which were seen as the reason for the failure of laissez-faire development, a new strategy was suggested: planning. The market won't do it -- so the government must solve the problem. For example, the government can invest in training because the government can capture the externalities. If it trains workers, it doesn't matter whether they work for one local firm or another, for the training will benefit the whole society. Government activity can also affect the vicious circles. For example, if government plans investment in a number of industries at the same time, the growth of these industries will provide demands for each other. One entrepreneur won't build a shoe factory because the small market demand means he won't make a profit. But if the government plans investment so that at the same time the country builds a shoe factory, a transistor radio factory, and a bicycle factory, there'll be enough demand created so that the firms' workers and owners will buy each others' products. This program will allow an attack on the vicious circle. This is generally called the balanced growth approach since it tries to balance investment, that all the production will be demanded. (Nurkse)

Albert Hirschman suggested an alternative strategy to overcome the inadequate market or the lack of demand. He argued that poor countries could use imports to build up a market of adequate size to support a minimally efficient factory. The imports could be stopped when a local factory got into operation. He also suggested that people would work harder and produce more in order to acquire new goods such as transistor radios. Hirschman emphasized that government should plan investments in those industries having the most linkages or connections to other industries. For instance, a shirt factory will set up a demand for cotton cloth; this will create a demand for raw cotton, etc. These are "backward linkages." On the other side, the shirt factory will create a need for retail outlets to sell the shirts. This is a forward linkage. If government can encourage investment in those industries with the most linkages, investment rates will be accelerated and development will follow.

But there remains one missing ingredient in the successful execution of this strategy, capital resources. Any of these efforts would demand large amounts of financial capital for the needed investments in physical capital. The planning strategy suggests several methods of obtaining the needed resources.

First, they can be generated by injecting capital from outside in the form of foreign aid or private foreign investment. This will raise productivity, which will raise income and savings, will increase the size of the market, will lead to more investment, and it will turn this vicious circle into a benign circle.

In addition to foreign sources, capital can come from within. (Lewis) The society can encourage private savings by interest rate policy or it can extract savings by its tax structure or by use of inflation to shift resources to the government. Finally, the society can draw upon the various agricultural surpluses to get the resources necessary for investment. Surplus agricultural labor can be moved to the factories and the people who are left behind can produce the same amount since the transferred workers weren't very productive. In the factories, however, they are more productive. In addition, in the factories they will be paid a subsistence wage, or a little bit above subsistence. But they will be able to produce output worth more than the subsistence wage. The capitalist will keep that difference as profit. He will then reinvest it, and that will lead to more capital being created, which will lead to more growth; and so the process of development is stimulated. As development proceeds, the capitalist will invest and will employ more workers, and income will increase. In the process of growth, income will trickle down to all segments of society. Rather than worrying initially about income distribution in a poor country where all you have to distribute is poverty, the strategy is to plan and to grow first. The society can redistribute later if it doesn't happen naturally. This is the "grow now, trickle later approach."

The clearest expression of this approach and its concentration on capital is seen in the Harrod-Domar model or the Mahalanobis planning model used in India. In these cases, a production function is specified, but it is in terms of capital alone. Thus only policy which affects capital will affect growth and development.

This is the basic strategy which was implemented in the late 1950's and 1960's. What have been its results?

A brief look at the 1976 World Bank Atlas shows that GNP has gone up, in fact it has gone up at an unbelievable rate. Some examples will show this. In Panama, for instance with $880 in income, for more than a decade per capita GNP went up at 4.5 percent per year. Or in Brazil, since 1965, per capita GNP has gone up at 5.6 percent per year. In the Republic of Korea, GNP has been growing at 6.8 percent for over a decade. These statistics are almost unbelievably high. These rates are much faster than England grew in its development process, for most estimates place the per capita income increase of England in the 19th century at 1.5 or 2 percent per year at the most. During the 1950's and 1960's it was common to double that rate. Some countries were able to triple it.

Recent World Bank data indicate that a significant change in this performance has occurred since 1970 however. While growth for upper and middle income underdeveloped countries continued, though at a slower rate, that for the poorer countries in the group was actually negative between 1970 and 1975. Thus there is reason for concern with the slowdown in growth rates and for alarm at the declines in the countries who need to grow.

Over this whole period of the planning approach to development, there were a number of other economic trends which were much less positive however. Three areas are of most interest: unemployment, income inequality, absolute poverty. Before surveying the evidence on these trends, a word of introduction is necessary. In each of these, the experience of growth has apparently benefited the poor little; and there are some indications that their situation has deteriorated over the period. But in trying to assess the impact on the poor, the first thing to be learned is that we know very little about them; interest in examining their situation and evaluating changes in it for policy purposes is recent. Thus, while there is much ethnological data which can reflect on this, it is fragmented and provides as yet little consistent measurement on these questions. Thus, definitive answers on trends in welfare of the poor are yet to be reached. Presented here are the conclusions which seem warranted from the consistency of the fragments of information which are presently available.

In employment, the general experience has been that unemployment has risen despite the high growth rates. Unemployment exists in the world today on an enormous scale, much more severe than in the 1930's. Some economists argue that world unemployment is going up at the rate of eight percent a year, and this is open unemployment, not disguised unemployment. Behind these statistics are people in cities who want work and can't find it. The most notable aspect is that this widespread unemployment emerged during the 1960's, a decade of world-wide expansion of trade and of rapid growth in the economies of developed countries.

In addition, unemployment often appeared in the countries that were growing the most rapidly. While the relationship is not exact, the countries which seemed to have the fastest rate of growth of GNP, also seemed to have the fastest rate of growth of unemployment, e.g., Jamaica, Pakistan, Trinidad, and Venezuela.

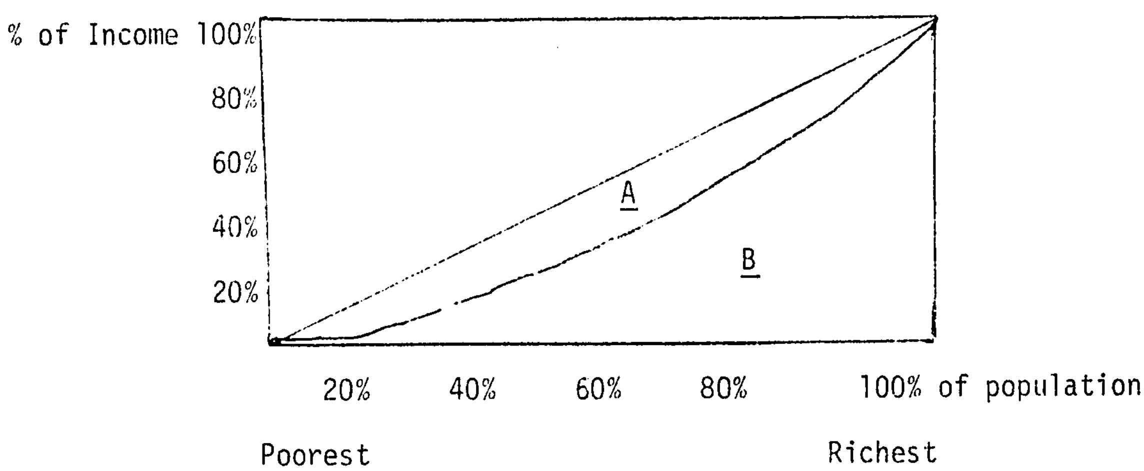
The universal nature of this unemployment, and the fact that it appears in countries of all the continents at the same time, makes it highly unlikely that it is just a result of policy mistakes on the part of governments. Its universal nature suggests the conclusion that there is something wrong with the system, that there is a systemic problem.

The second change that is apparent in the data is an increase in the inequality of income distribution in underdeveloped countries. The World Bank has reported changes in income shares, and what happened in Brazil is an example. Since 1965, Brazil has been increasing its per capita GNP at the rate of 5.6 percent a year. At the same time, the share of national income going to the top five percent of the people has risen from 29 percent to 38 percent, according to the government's own estimates. Private estimates have been made which indicate that the top five percent receives as much as 46 percent of the national income. In Brazil, during this miraculous performance, the top five million people have been receiving as much of the national income as the bottom 90 million. Just share and share alike. In Kenya, the top 20 percent are said to be getting 68 percent of the income. In Ecuador, the top 20 percent is getting 74 percent of the income. In Turkey, the top 20 percent get 61 percent of the income, etc.

Inequality has increased. Economists measure income inequality on a graph, in which they put the population on one axis and their income on the other axis. Figure I is such a graph. The diagonal line represents perfect equality in income distribution. If the poorest 20 percent of the people got 20 percent of the income, then that would give us a point on the diagonal. If 40 percent got 40 percent of the income, etc., all points would be on the diagonal. This, of course, is not the case in any society. If we were to take actual data from a country and were to plot it, we would get a line like the curved line. We call that the Lorenz Curve. A curve closer to the diagonal indicates more equal income distribution. A curve closer to the bottom axis indicates greater inequality. We can summarize this by computing what is called a Gini coefficient. The Gini coefficient is simply $\frac{A}{A+B}$ where A and B are the areas on the graph. If the Gini coefficient were zero, we would have a completely equal income distribution. (Area A would equal zero.) If the Gini coefficient were one, one small group at the top would have all of the income. A would cover the whole area of the graph.

Figure I

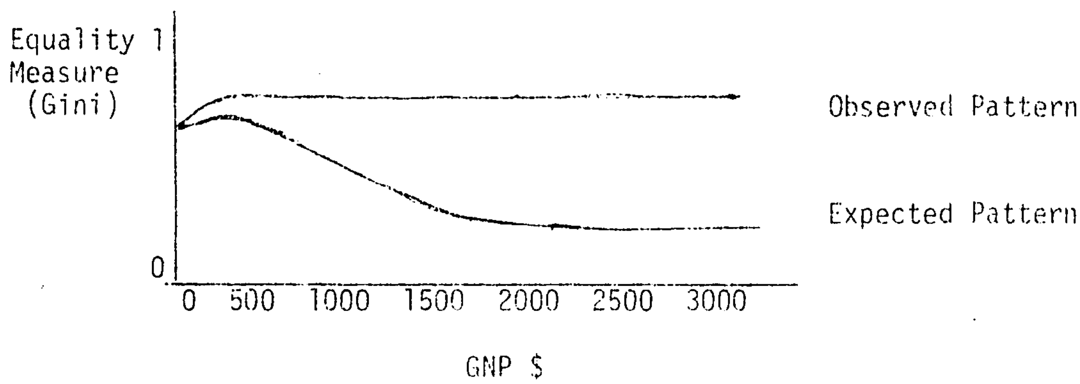
The Lorenz Curve



The trickle down theory would suggest a relationship between this measure of inequality and the income of economies. More precisely, if we took data on a series of countries and plotted on another graph a measure of equality on one axis and the level of GNP on the horizontal axis, the trickle down theory would suggest that higher GNP should lead to improvements in the equality of income distribution. However, if we look at the actual data, no such relation emerges. Graphed below are our expectations from the model and the actual results discovered by Chenery. We see there that over very large ranges, there is very little reversal of the income inequalities which appear in the early phases of development under this model.

Figure II

Relation Between Equality and GNP



A third area of concern is poverty: the inability of persons to provide for their basic needs. Adelman and Morris did a study for the World Bank on what had happened to income shares in 43 non-communist, underdeveloped countries during the post-World War II period. They found that as economic growth proceeded, the share of the bottom 60 percent of the people fell relatively. This was the pattern noted above and was not terribly surprising because it had happened in England too. Kuznets has demonstrated that as growth proceeds in the initial period, income becomes more unequally distributed. But Adelman and Morris found, (which was absolutely new and very shocking) that the income of the bottom 40 percent had fallen absolutely as well. The people in this bottom 40 percent had less income in absolute terms at the end of these two decades of development than they had in the beginning. The bottom 40 percent continues to lose absolutely, until you reach a per capita income level of about four or five hundred dollars, that is, until you get to Latin American levels of income.

Adelman and Morris' statistical results seem to correspond to evidence gathered in certain other areas as well. In India, the bottom 40 to 50 percent of the population now lives below the official poverty line, which is $50 per year in 1961 prices. This is the level where malnutrition begins. And, more importantly, the income of this bottom 40 to 50 percent has gone down over the past 20 years, even though India's per capita income is going up. John Mellor is a bit more circumspect in treating this question but he feels that we can conclude that there has been no improvement in the situation of these people.

In Pakistan, during the heyday of rapid growth in the sixties, real wages in the industrial sector declined by one-third, as pointed out by Haq (1976). The same thing happened in Brazil. Hansen found that incomes of laborers in Northern Mexico declined from $68 per year to $56 per year from 1950 to 1960. So we can conclude that this model led to increasing inequality and also led to increasing poverty.

The importance of this result derives from our earlier definition of the good life. What planning seems to have brought is an enhancement in the good life of a small elite class, while increasing the good life for the poor very little or perhaps even removing them further from attainment of the good life. This has very tangible effects on the lives of the poor: malnutrition and fetal brain damage rises; infant mortality remains high; life expectancy remains low; the fruits of economic development are simply not delivered.*

These pessimistic results raise the question of why the planning strategy didn't work. Several explanations look to the way the programs were carried out. First, the capitalists didn't save and reinvest. They sent their money abroad to keep it from being expropriated in case of a revolution; for they are rational economic men and realize it is less risky to invest in the United States than in Argentina, etc. In any case, there has been great capital flight from underdeveloped countries. A similar negative influence has been the flight of educated labor from the underdeveloped countries, the brain drain. A recent study indicates that this factor has added $30 billion to the U.S. GNP. Another point is that the countries chose the wrong form of government. They used a mixed government, a part of socialism, and a part of capitalism. They had hoped that they would get the best of both,

* The recent development of the Physical Quality of Life Index (POLI) is an attempt to deal with these questions. Its success remains to be seen. (See ODC; 1977.)

instead, they got the worst of both. They got the bureaucracy and inefficiency of socialism without its equality; and they got the inequality of capitalism without its efficiency. So the mixed system gave them the worst of both.

In addition, the countries relied on foreign aid and foreign investment, and this led to a distortion of the production function, since it was generally directed at capital intensive projects. A country couldn't get foreign aid to hire workers, rather it had to be used to build a dam, or a steel mill, or a school. The end result was to distort the price of capital, to make capital cheap relative to labor. As a result, capital intensive technologies were used, and they simply didn't employ many people

But not all the problems were in the execution, many were obviously in the conception of the strategy. Several are worth mentioning.

First, it was realized that you can't grow now and redistribute income later because of the structures which develop with unequal growth. For example, as you grow, the people who are getting the money have increasing political power and won't let redistribution take place later. They get more and more income, more and more power, and this allows them to block redistribution. Another factor is that income becomes embodied in goods, and goods can't be redistributed. Income becomes Jaguars, or Mercedes, or luxury apartments or college educations. There is no way to turn a Mercedes into bicycles or a luxury apartment into public housing. So the income has become a stock which cannot be redistributed.

A second fault in the strategy is that the poor moved into the cities in far greater numbers than theory assumed. Todaro has done a study in which he argues that for every job that opened up in the cities, three people came in looking for jobs. So for every job created, the word goes out, and three persons come looking. For every job created, two people are attracted who are going to be unemployed.

Another factor contributing mightily to this is the "demonstration effect." The poor countries tried to emulate the standard of living in the rich countries. They tried to live like we do, and they don't have the resources to do that. The possibility of living like we do was a major magnet in drawing people from the rural sectors to the urban area.

It also came to be realized that certain key aspects of the development process had simply been ignored. Agriculture was one of these. It had been given the role of fueling the industrialization process by providing the various surpluses. But it turns out that this fueling was often at the expense of the vitality of the sector and in many cases agriculture has become unable to provide the basic food needs of the population. Similar benign neglect was accorded broader social and political aspects of development. Little concern was given to social and political mobilization and participation.

To sum up, recent evidence has indicated that the planning strategy's benefits have not accrued to the poor. As a result it has been realized that simple concentration on growth has effects which are unacceptable. So in specifying our criterion for development, we must modify growth to take into account considerations of equitable distribution of benefits. One way of stating this is that there is a "social welfare function" which we must use in evaluating economic performance and that the unemployment, inequality, and poverty which have accompanied the planning approach violate this social welfare function. Thus the strategy must be modified to take into account these broader considerations. In addition, in admitting that growth is not satisfying the social welfare function, questions of values and ethics must definitely enter into consideration. Thus the work of development ethicists becomes important in assessing development strategies and attainments.

Is there an alternative to the laissez-faire or planning strategies? Such a question will lead us in Section V into the growth and equity approach. But for now, we will turn to a completely different approach, the political economy paradigm.

III. The Political Economy Paradigm

In the first sections of this monograph, we introduced the idea of a scientific revolution as developed by Thomas Kuhn. He examined the course of changes in thinking about physical science phenomena, and found a common pattern. An existing paradigm which had explained a great deal gradually confronted new questions which it couldn't answer. Mild consternation reigned among theorists until a new paradigm was formulated which could explain the phenomena and which supplanted the old.

While the very nature of social phenomena makes it unlikely that such a neat progression would occur in thinking about economic development, there is without doubt a vigorous competition between the conventional paradigm and another world view we will call political economy. In specifying this alternative, we will follow the same basic outline used in the first case, starting with a specification of the assumptions of this theory.

i. The Assumptions

Political economists make assumptions about the same three aspects as the traditional economist. First of all, with respect to human nature, they would agree that people are rational. But in addition they would argue that people act in groups, they act together to meet their needs and hopefully to provide a surplus. Thus there is a social dimension to the individual's actions which is missing from the traditional approach. Secondly, the good life has two dimensions. At the minimum it means the ability to meet basic needs, such as food, clothing, shelter, medical care, and education. But beyond necessities, the good life comes from social activities. People derive welfare from singing, from dancing, from working, from theorizing, from making love. Thus, a society which attempts to provide the good life, must facilitate such social activities. Having provided for the basic needs, provision for social activities requires three conditions.

First of all there must be certain instruments, or tools. In order to be able to paint you have to have paints and a canvas. In order to fish, you must have a fishing rod; for without these instruments the activity would be impossible. This is where traditional economists stop, for they look mainly at the tools, at the goods and services, and assume that the good life derives from them. But the political economist would place equal emphasis on the existence of capacities, i.e., in order to derive welfare from music, one must have the capacity to make and to enjoy music. Thus, society must provide the encouragement and training to develop our human capacities to the fullest.

Thirdly, you need a social context, or an environment in which to carry out activities. In order to be able to fish, it is necessary to have access to an unpolluted river. In order to be able to enjoy the beauties of nature, access to nature is essential. Society and relationships with fellow human beings must provide these basic conditions.

Turning to the good society it should be apparent that it is one which enables people to meet their basic needs and to carry out their preferred social activities. But we can be more specific and can suggest that such a society should have four specific characteristics.

First of all, it has to ensure consumer sovereignty. It must provide the goods and services people want, including the instruments of social activity. This parallels the traditional view though it gives added emphasis to consumption or participation in social activities.

In the second place, it must facilitate worker sovereignty. People must have the kind of jobs that they want, jobs that they find meaningful and that enhance their human capacities. The good society has to have some way of adding up people's preferences and of generating the kinds of jobs that people want, just as it must aggregate preferences to find out what kinds of goods they want. A variety of mechanisms could satisfy this aspect: labor mobility among jobs of widely different character; control by workers over their job situation; or provision of capital resources to laborers to allow them to establish their own undertaking. Whatever the mechanism, this characteristic is important because work is not seen as equivalent to pain; rather it is an activity in which humans develop.

Third, a good society is one which exhibits citizen sovereignty, which provides a mechanism to aggregate people's preferences for community. What will be the community with which an individual interacts? What kind of community do people want? What kind of environment do they want? With citizen sovereignty, a way to express preferences and to control communities must be provided to the citizens. Again a number of mechanisms may be found which satisfy this requirement, and they may be quite different from our usual image based on voting procedures in the U.S.

Finally, the good society must acceptably solve the problem of equality. While this question was more or less added onto the traditional paradigm, it is an essential portion of the political economy paradigm. There are a variety of ways equality is dealt with. For example, Marxists deal with the functional distribution of income between capital and labor by going back to "the labor theory of value" which implies that all output (or value) originates with labor and thus any income not returned to labor is a result of exploitation. Other political economists concern themselves more with the size distribution of income. One approach used by Cline is to take one existing income distribution, e.g., Britain, as the goal and then to assess policies in that light. Another approach, based on philosophical ethics is that of John Rawls. In his <u>The Theory of Justice</u>, he laid down criteria for equality widely accepted by political economists. He argued that in a good society, the benefits from that society and the responsibilities to it should be equally distributed; everybody should have equal benefits and equal burdens. But inequality will be permitted if it meets two conditions. First of all, inequality is possible if it benefits everybody. If everybody in the society is better off because some people have a position of privilege, then that makes sense. Everybody, including the poorest person, is better off as a result of the inequality. Secondly, the positions of inequality must be equally accessible to everyone. Everybody has to have equal access to the positions which provide greater than average benefits. If these two conditions are met, then inequalities are permissible.

In summary, these assumptions are more complex than in the traditional paradigm simply because goods and services are not seen as the only means to attain welfare. Specifying additional sources of welfare necessarily complicates matters.

ii. Criterion

Of course the definition of development follows from these basic assumptions. Political economists such as Denis Goulet define development as "liberation." This means liberation from oppressive and exploitive relationships in two spheres. First of all, liberation internal to a nation state means to reorganize society so as (1) to provide for everyone's basic needs, (2) to provide everyone with meaningful work, (3) in a context in which people have satisfying relationships with their fellow human beings, (4) in a healthy environment, (5) in a society based on equality, (6) and consistent with people's core values. Now these are very different goals from those of the traditional economist who concentrates simply on goods and services. In addition, traditional economists look on people's values as means. Since the goal is growth, if people's values have to change in order to get growth, then society must change their values. But for political economists, one goal is to enhance people's core values. Development becomes the means, not the end, for the end is to enhance what people value. Development or growth contributes to liberation only if it is consistent with their deepest values. (Goulet)

The second stage of liberation is in the international sphere. Political economists argue that the underdeveloped countries must free themselves from their position of subordination and dependency on the rich, developed countries. This means establishment of a new, and non-exploitive international economic system based on self-reliance.

Thus once again, the meaning of development is much broader in the political economy approach.

iii. The Methodology

Many of the phenomena perceived as problems in the tradi- tional paradigm are seen by political economy as inherent aspects of the functioning of capitalist systems. Many of the factors omitted by the conventional approach are at the center of the political economy methodology.

John Gurley encapsulates much of the political economy approach as follows:

> Social Scientists these days usually suppose that all governments really want economic development, and if they do not achieve it, then it must be because the problems are unusually difficult to solve, or that solutions take a rather long time to work themselves out. Persistence and technical knowledge are what is required for success. This supposition, however, does not adequately take account of the class structures of societies, the often conflicting aims that exist among the various classes, and the class nature of "success" and "failure." When poverty is looked at from the standpoint of the ruling classes, it may not be a failure of the system at all but rather a prerequisite for the continuation of their accumulation of wealth, their privileges, and their social, political, and economic domination of the society.
>
> This is partly because poverty is often the carcass left from wealth acquisition; or, at best, it is stag- nant backwaters of society, not yet touched by a development process that stresses private profit-

> making and hence efficiency and "building on the best." But poverty persists also because it is closely associated with peasant characteristics which are highly supportive of the existing class structures and hence of the privileges and wealth of the dominant classes. I refer to the peasants' illiteracy, passivity, obedience, fatalism; to their lack of awareness of the world around them and therefore to their propensity for mythical and spiritual explanations of personal hardships and disasters; to their lack of organization, their willingness to work for very little; to their being easy set-ups for all sorts of manipulation by their "superiors".
>
> A thorough-going programme of economic development, which is spread widely and reaches deeply into the structure of the society, is a dangerous thing to ruling classes, for it tends to undermine the very attributes of the masses of people that nourish the wealthy and powerful. Such a programme awakens people, and it is often best that they doze; it mobilizes people for gigantic economic efforts, and such organization can be turned into political subversion; it sweeps away illusions, but may open their eyes to the causes of their own oppression.
>
> Furthermore, any serious economic development programme that involves industrialization threatens existing class structures by creating new economic bases from which arise new social classes, and weakens the economic foundations which support the present dominant classes.

One main implication of this approach is that the key problem for investigation is underdevelopment rather than development, and as a result, far more effort is spent on the former. The theory of development is much less completely elaborated, at least partly because every transition will differ depending on historical situations and core values. Thus, a complete treatment would require a series of case studies, which is far beyond the scope of this work.

Several main characteristics describe the political economy methodology. First of all, it is <u>holistic</u>, it takes in the entire society. A simple model of a functioning and changing economy may aid our understanding.

We start with the ecological system, having both a physical (land, air, water, resources) and a biological (plants, animals, including people) component. This ecological system is the basis upon which human life rests and it sets limits on the kind of system that can emerge.*

Figure III

Ecological

System

A. Physical

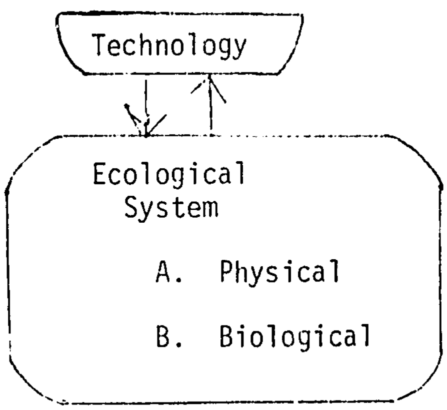
B. Biological

The ecological system has a particular impact on the type of technology chosen, i.e., the way people do the work necessary to maintain life. In a relatively well endowed region, the technology may be simple and yet allow people to live at adequate levels of comfort. One can think of some of the islands of the South Pacific as examples. In other places the ecological system requires people to invent a more sophisticated technology in order even to maintain life. An

* We should note here that man/woman are the central focus of what we are calling the "ecological system." It is their interaction with institutions and technology which provide the motive force for the system. In particular, we emphasize that there is no basis for a common critique of political economists, i.e., that they are materialists who hold that technology and material conditions completely determine the nature of man. Harrington goes back to Marx to refute this and says for Marx, "the data of man's senses were not simply given by a world out there; rather they were progressively human products, human needs, human responses. The way we see and touch and hear is the work of our previous history, not of blind, inanimate, deaf nature." (p. 168)

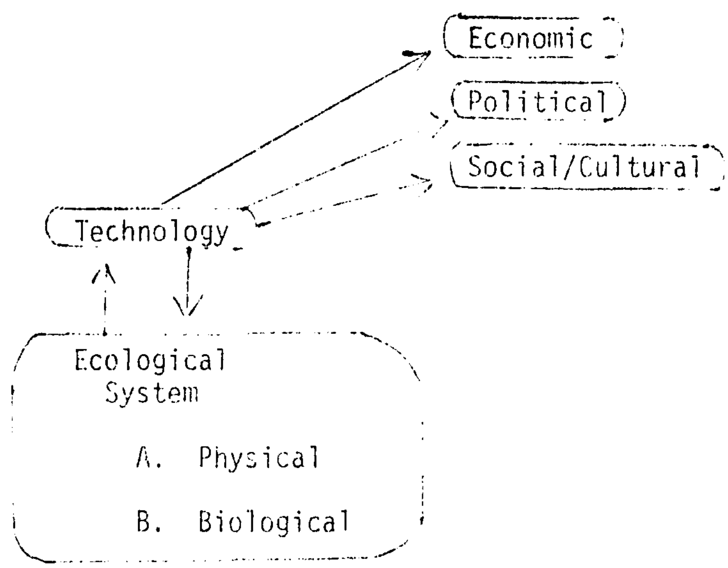
example might be the intricate cropping patterns in tropical agriculture or terraces in highland areas. In any case, except for rudimentary gathering societies, people interact with the ecological system through technology. There is a mutual interaction, with the ecology affecting the type of technology, and technology affecting the ecology. We are all too aware of the latter today as pollution from human activity degrades the environment.

Figure IV



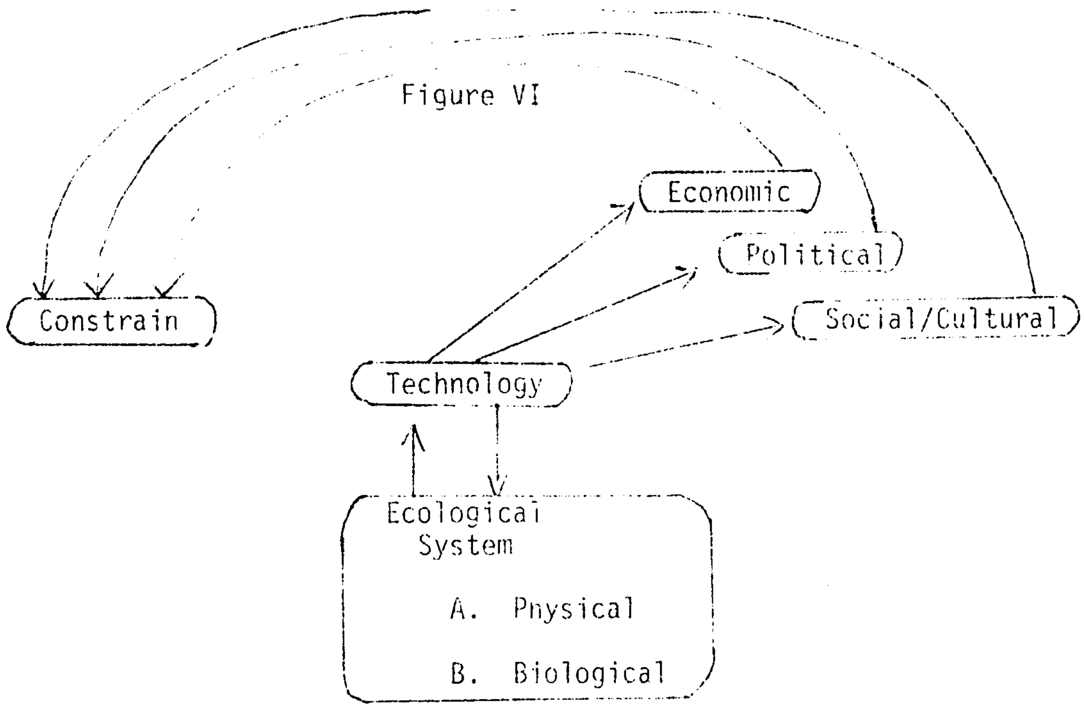
But people are social beings and the technology which is created has an important impact on the social, political, and economic institutions which exist. There is no dearth of anthropological studies of institutional changes caused by introduction of a new technology. This does not imply a simple technological determinism, but it highlights the fact that technological change tends to be the entering wedge in the initiation of social change and "progress." When far-reaching technological changes are introduced, other institutions change and since people's relationship with technology and with the ecological system is mediated by these institutions, the society must change, too. This is represented in Figure V.

Figure V



Any number of examples of this process could be given, but perhaps the most commonly used is the invention of textile machinery in England and the impact of the industrial revolution. The extended family was altered, the nuclear family emerged as the basic social institution, the Protestant Ethic emerged as the dominant value system. In addition, the political power of the bourgeoisie waxed as the power of the landed aristocracy waned and capitalist economic institutions replaced feudal ones. All these changes took a very long time and various institutions from the old system survived intact alongside the new ones. Nevertheless, one can argue that a change in technology -- over time -- led to a great transformation of the whole social system.

However, once the social/cultural, political, and economic institutions become established, they then constrain the type of technological change which is possible. If hierarchical social, politica and economic institutions are created, e.g., the capitalist firm, it will be difficult to introduce a technology which requires democratic and egalitarian relationships.

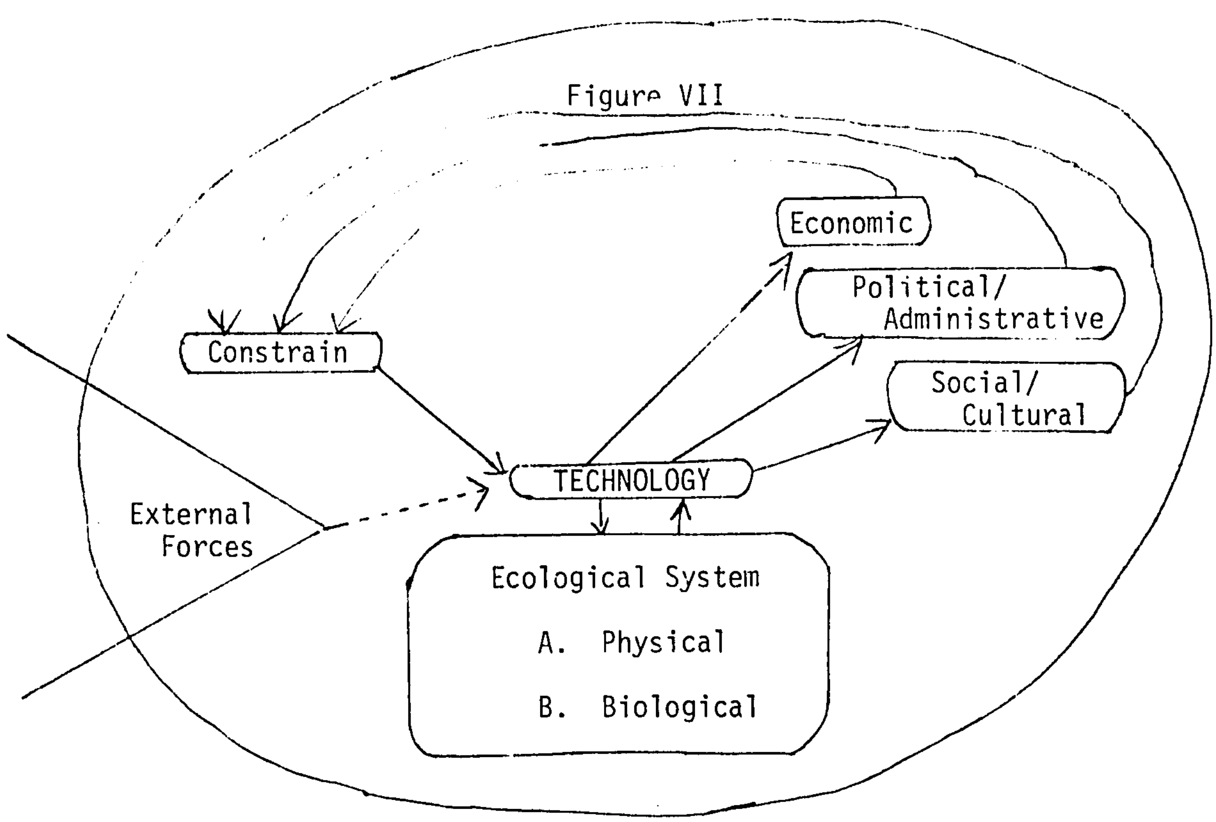


There is an obvious interrelationship between the social/political/economic institutions and the technology that is created. One can think of Burmese society as one which has rather effectively blocked the introduction of Western technologies. One can also think of the Chinese efforts to shape their technology to fit the social/political/economic system they desire, or the similar effort under way in Tanzania.

It should be pointed out here that the treatment of technology in this paradigm differs fundamentally from that given it in the traditional paradigm. In the latter, technology is seen as a shelf of blueprints which can be culled to find that which is most appropriate for existing prices. Additions to this shelf, technical change, result in higher levels of output for given inputs. From the political economy perspective, technology cannot be separated from its relationship to social structures. Indeed, development must come about by substantial and simultaneous changes in both: radical alteration of the institutional structures which open up a new and more rational technology and allow for a more effective interaction with the ecology.

However, no social system today is isolated from external forces. Those forces come in many forms -- new values are introduced from outside the system, i.e., advertising; new economic institutions are imposed, i.e., multinational corporations; etc. One way to represent this is to attribute it again to new technology which can be seen as the entering wedge -- coming in from outside the system and leading to change in all the other institutions.

Figure VII



In this model, important emphasis is placed on the role of technology as a major determinant of change, the interdependent nature of the relationships between elements of the system, and the comprehensive and hence very general level of the model. It may be best understood as a descriptive model, but it does suggest analytic hypotheses to the political economist. It quite obviously ties back into specifications of the good life and the good society as well. The one area which receives greatest emphasis from political economists is technology and its interrelations with the institutions of society. Good examples of this type of analysis are Merhav and Thomas.

A second key aspect of the political economy approach is its emphasis on history. The situation of the underdeveloped countries cannot be understood except in an historical context and more importantly as a result of a definite historical process.

While each individual country has its own history of underdevelopment, a process Andre Gunder Frank terms "the development of underdevelopment," some common themes can be extracted to give a flavor of the analysis.

The starting point is the period of European instability in the late 15th and early 16th century which resulted in the destabilization of the remainder of the world, e.g., the Inca and Aztec empires, the Moghul Kingdom, etc. Later instability came in the 19th century with the all-out competition for colonies. New technologies, mainly of war, were introduced into these societies. Along with them went the worst abuses which are familiar to us all: out-and-out racism, slavery, genocide, disruption of political and economic structures, debasement of basic relations and cultural values. Of course, there were many positive impacts also. The idea of equality, the ideal of progress, and new technical and organizational forms of necessity were transmitted.

But these positive and negative impacts are not what the political economy paradigm takes as its primary concern. The key aspect of these interactions is their asymmetry, the fact that the influences are in one direction: Europe -------> Underdeveloped. This was the beginning of a long relationship of domination/dependence which has continued even up to the present and which is essential to the development of underdevelopment.

The historical rendition which follows is obviously not applicable in all aspects to every country. The resource-poor countries such as Chad are most often cited. However, even in these cases, the same pattern of dominance-dependence can be seen to have occurred: displacement of an existing political-economic structure; substitution of a new political structure dependent on foreign support; displacement of the traditional economy so that it more nearly serves the needs of the dominant country; establishment of a domestic elite dependent in its consumption patterns and in its source of income. The mair difference in these cases is in the lesser magnitude of the deviation induced by dependency between the present-day economic situation of the poor country and the situation which it might have attained under more autonomous conditions.

In sketching this interaction, let us take as the starting point the types of changes which were going on in Europe in the early 19th century, the time of the Industrial Revolution. Development has two sides, a demand side, and a supply side. On the demand side in Europe, there were new tastes and new wants. There was also a change in supply, as Europe was going through an Industrial Revolution, a technology transformation. The whole economy was being transformed, for capital was being accumulated and was growing more rapidly than the labor force. But if capital grows more rapidly than labor, what is going to happen to returns to capital? If capital becomes relatively abundant, labor becomes relatively scarce, and this means that wages would go up, and profits would go down. Such a result was surely unacceptable to the capitalist entrepreneurs, and they had three ways of dealing with it.

First, they "encouraged" migration from the countryside, or from other countries. This kept the labor force abundant, and maintained low wages and higher profits. A second strategy was to automate, mechanize, and substitute capital for jobs. This also created more redundant labor. The third approach, of greatest interest to us, was to invest one's capital abroad. Thus, capital owners sent their capital abroad; and since capital was scarce in the poor countries, the returns were high. In understanding these investments, we will begin to understand the historical process which developed underdevelopment outside of Europe and the U.S. at the same time it developed internal development in Europe. There were two main types of investment.

First of all, much investment was in plantation agriculture. Following the principles of comparative advantage in the tropics, capital began producing things which could not be produced at home. Thus, there were investments in coffee plantations, sugar plantations, tea plantations, rubber, etc. This investment in plantations did not significantly transform the way work was done, there was no technological transformation. The plantations used essentially the same technology that had been used before, but on a much larger scale. Thus, the technology wedge did not have the effect of stimulating the internal development of the underdeveloping countries. One other impact was construction of transportation to get the coffee and the cocoa to the sea, but it resulted in a system of railroads which run from the plantations to the seaports. This linked the plantation to the mother country, but did little to link the parts of the colonial economy and thereby to transform it. So there was no industrial revolution, there was little development of local skills. However, there was a substantial "demonstration effect" and a political impact which became increasingly important over time.

The second type of investment was in extractive industries: first silver and gold, then bauxite, copper, tin, and petroleum. But this type of investment did not transform the colonial economies either; no industrial revolution took place. Small, rich enclaves grew around the mine sites, the same export-oriented transportation construction occurred. A few laborers developed high level skills, and received hign incomes, distorting internal income equality. Much of the foreign exchange, which could have had a transforming impact, was lost, and went to pay for imports for high income groups or for the repatriation of profits.

So neither kind of investment had a transforming effect on the colonies. The dominant technology in the colonies was the same before and after the foreign investment. There were other changes, however. People who had been subsistence farmers were turned into landless laborers as they were driven off the farms. The Europeans "took" the best land and drove the people off the farms into the mines or onto the plantations. They used all kinds of systems, the head tax, etc., to get them to work. But in any case, they turned a group of self-sufficient farmers into a group of landless laborers who had lost their economic self-sufficiency.

There were certainly economic gains from these changes: increased output/income, increased exports/imports. However, the gains went to three different groups of people: to the Europeans who did the investing; to the expatriate elites who came from Europe and North America to manage the mines and plantations; and finally to the local elites, who served as managers, supervisors, overseers and foremen.

What did these expatriates and the local elites do with their gains? First of all, they used them carefully to establish and maintain political and security structures which ensured their continued dominance as a class. Secondly, and of importance in the purely economic sphere, the local elites and expatriates used the gains to import those very same goods from Europe and North America which they had been used to buying. They brought in the bottled water from Vichy, the wine from Bordeaux, the suits from Saville Row, and the cars from Detroit so that they could continue to live in the colonies the same way they had lived in London or Paris, or supposed they would have had they been born English or French. Of course, in order to maintain this level of consumption, they had to have very high incomes and to ensure the continuance of these incomes.

This first stage of underdevelopment is often called the comparative advantage stage. In it, the gains from trade are taken over by an imperial power, its agents and local client elites, and a pattern of consumption is created based on imports from the developed countries. No transformation occurs, but structures of underdevelopment are consolidated.

The second historical stage can be termed the import substitution phase. Import substitution was stimulated in two ways. The depression and the Second World War severely disrupted trade in manufactured products, making it difficult for the local elite to obtain their high income consumer goods. Thus the domestic market was open and protected in this period and many enterprises entered this type of production. But secondly, domestic industrial production provided a new source of income and wealth to those members of the elite class who entered it. It also corresponded nicely with the investment emphasis of the planning strategy in the 1950's; thus, import substitution became policy under the umbrella of protective tariff structures. The main justification for such policies was the scarcity of foreign exchange for these countries, and import substitution was supposed to relax this stricture.

The countries began producing at home what had previously been imported. In some cases such as Brazil, by the late 1960's over 90% of most consumer goods were produced domestically. But the goods which were produced were those designed to satisfy a demand - that is a want backed by money. Of course, this implies that the goods produced were for the rich -- substitutes for previously imported luxury goods. Profit-making firms are not going to produce goods for people who have no money, so basic wage goods such as food get short shrift. The result is most visible in poor countries, when enormous luxury apartments are separated by a few blocks or miles from the favellas, the slums, and the shanty towns. And that's exactly what you would expect in this model of development.

Two factors aggravated the negative impact of this process. First, the result of import substitution was to require more foreign exchange than before! The reason is that capital equipment, intermediate products, or in some cases raw materials, had to be imported to allow production at home. It turns out that the foreign exchange component in the goods consumed by the rich even with import substitution is much greater than that of goods consumed by the poor. Thus, if you produce in Thailand to satisfy the needs of her rich, you'll have to import much more than if you produce to satisfy the needs of the poor.

Secondly, the capital intensity of production was greater. Studies show that in general, the rich consume a more capital intensive bundle of goods than do the poor. (Soligo) It takes much more capital to produce a car, than a bicycle. Thus, even if the rich do save out of the unequally distributed income, the country will remain capital poor and foreign exchange poor because the goods that are produced require more capital and foreign exchange since they are for the rich.

It is like a cat chasing its own tail. As theorists claimed, more savings may be generated if the income goes to the rich; but their demand for capital intensive goods requires still more savings. The poor, on the other hand, consume labor intensive goods.

The import substitution strategy had certain spill-over effects which benefited the poor. The people in the slums now have an electric light and they have access to water supplies, etc. Nevertheless, the import substitution phase did not transform the lives of the majority of the people in the poor countries and there was no technological transformation in the way work was done.

A third historical stage was the multinational corporation stage. The process of growth in underdeveloped countries in the 1950's, coupled with their high tariffs led more foreign firms to begin to carry out production in these countries. Multinational corporations moved in and often started buying out local firms. In some cases, they produced the same kinds of goods as the domestic import substitution firms; in others, entirely new types of goods were produced in underdeveloped countries to satisfy luxury wants: color TV, sugar pops, etc.

Of major importance was the transplantation of the ideology of consumerism; the very powerful mechanisms of advertising, spending billions of dollars a year, convinced people in the poor countries that the good life comes from drinking Coca-Cola. If you really want to be with it, you drink Coke; for the good life comes from consuming those things which the multinational corporations produce. And although the income hasn't trickled down to the poor, the ideology of consumerism has. So even very poor people spend their money on Coca-Cola, lipstick, potato chips, and baby formula.

The type of technology multinationals introduced was exactly the same kind of technology that they used in the rich countries, because to set up new type factories or processes would have been very costly and time consuming. But they had a mangement that knew how to manage a capital intensive factory and its attendant labor relations. And thus, they used this capital intensive technology, even though the poor countries have mainly labor in abundance, not capital. Thus, the technology which was appropriate in the U.S. or Europe was transplanted to countries where it wasn't appropriate. For capital intensive factories employ very few people, and increases in output had no impact on the unemployment problem. A few jobs for skilled workers were created, but very few jobs for unskilled workers.

What are the major effects of these activities? It has resulted in further concentration of income in underdeveloped countries. If production occurs in a factory with much capital and few workers, the income from that factory will primarily go to the capitalists. Some small group of laborers will often benefit greatly as well, but the overall effect will be greater inequality. Another very important effect of this investment has been to erode domestic governments' control over their own economies. This is seen most clearly in the case of foreign exchange and tax policy. In the first of these, firms have been able to repatriate large amounts of foreign exchange in payments for licenses, patents, royalties, technical advice, etc. The neatest of these devices is transfer pricing which also allows the evasion of taxation by Third World governments. Let's look at this device.

Take the case of a multinational operating two subsidiaries, one in Panama and one in Ecuador. Panama doesn't tax very much and Ecuador does. So the plant in Ecuador brings in goods from the Panamanian subsidiary, for which the price is set to benefit the whole multinational. Of course, the price is set very high for the Ecuadorian plant. When there are sales from Ecuador to Panama they are at a very low price. So the Ecuadorian plant at the end of the year shows no profits. This is a very successful device and avoids taxes by transfer pricing. It also allows the export of foreign exchange.

The final result of this historical stage is that the economies of the poor countries have come to be dominated by the multinational corporations, especially their potentially most dynamic sectors. In many cases, what has arisen is a three-sector economy: a top sector, which is the very profitable, high technology sector, e.g., chemicals, and electronics, and which is dominated by multinationals; a middle sector which is less profitable and less technologically dynamic and is run by the state, e.g., steel mills, the petroleum industry, or public works; and a third sector, less profitable still and very backward technologically, which is run by the local capitalists, e.g., food and clothing. Ample documentation of this pattern in Brazil and Mexico is given by Mueller and Newfarmer.

But the end result remains as in the earlier stages: growing inequality; growing pressure on balance of payments; and continued dominance of the Third World economy from outside. This is the historical process which concerns political economists.

It is possible that we are now entering a fourth stage, the export platform stage. In this stage, the multinationals produce goods in the poor countries which are re-exported to the United States and other rich countries. Such a pattern would fit Hong Kong, the border industries in Mexico, etc. It is unlikely that this will have different results than earlier stages.

Leaving the historical component of the methodology, let us turn to the final component of the methodology, concern with income distribution. Political economists emphasize income distribution as being a key determinant of the kind of economic development that takes place, giving two main reasons.

First of all, distribution of income determines the structure of final demand. The kinds of goods and services that are demanded will be a function of who receives the income and what their preferences are. What finally gets produced depends on final demand plus the relative cost of producing different goods. Thus, if people who have the income want organ transplant clinics in Bogota, rather than paramedics out in the villages, that is what the economy will produce. A poor country can't produce both kinds of goods. The U.S. can do both, but poor countries can't. This implies that what is produced in poor countries is goods primarily for the rich even though in many cases the relative costs of production are quite high.

In contrast in a poor country, with an equal distribution of income, what would be demanded? Food, clothing, shelter, and other basic goods. Many goods won't be produced at all. On the other hand, as income goes up so that people can afford say a bicycle, the society must be able to produce enough for everybody who wants one. Thus, new consumer goods can't be introduced for sale until enough for everybody can be produced.

Short of this, there must be collective consumption: laundromats instead of privately held washing machines; buses instead of cars; community recreation centers instead of individual television sets, etc.

The second reason that income distribution is important is that it determines who controls the social surplus, and to what use it is put. The social surplus is a concept that goes back to Adam Smith, and is represented by the total output of a country, minus the socially necessary consumption. It is the social surplus which is available for future investment, and the distribution of income determines who controls the social surplus.

To see this, we must realize that capitalism grew up domestically within England or the United States. But in Third World countries, as Baran put it, "Capitalism came in the Prussian way." It was imposed from outside, and the outside capitalists aligned themselves with the local feudal elites. There weren't the enterprising businessmen who appeared in Western European capitalism. So the people who control the social surplus in the poor countries are often not the reinvesting entrepreneur types but people interested in keeping their own position. They don't want to change the society so they align themselves with external forces to keep things just the way they are; and they expend the social surplus in this effort. So the result of the distribution of income is an unproductive use of the social surplus with major portions of it spent on luxuries, sent out of the country, or used to control political and military power.

With this, the basic methodological stand of political economy is complete. However, it may be worthwhile to point out more precisely some ways in which it differs from the neo-classical paradigm.

Political economists accept much the same analysis of resources as that used by traditional economists, while putting an entirely different emphasis on technology and entrepreneurship. But most importantly, political economists reject the institutions which the traditional paradigm posits, seeing in them the result of a process of underdevelopment and a mechanism which blocks liberation. They argue that capitalist development in underdeveloped countries will not succeed today, that LDC's cannot follow the paths the United States or the United Kingdom followed, and that, instead, new institutions are needed. The neo-classical parable is rejected in toto.

Some of the specific points made should be noted. Political economists agree that capitalist development in Brazil is much like it was in Europe: in both, income inequality increased with growth; in both, unemployment increased; in both, capitalists controlled the social surplus; and, finally, in both, there was no income redistribution during the process of industrialization. But political economists argue that there are crucial differences which mean that capitalist development will not ultimately succeed and that the difficulties of those countries which are following the traditional paradigm are not surprising.

Among these differences are that the new goods are imported today, rather than being developed domestically; the technology is also foreign, its capital-labor ratio is inappropriate; production units in the poor countries are monopolistic or oligopolistic, not the competitive firms of England, which leads to slower growth and more concentration; unemployment today is much greater than it was in the European case, because of the population explosion; today's developed countries were never colonies, and so were able to take advantage of the international economy rather than being victimized by it; and finally, today's developed countries didn't have a socialist alternative, though the underdeveloped countries today do.

Political economists would argue that there is an enormous pressure on poor countries from an example like China, a country which is apparently able to meet most of its people's needs, despite very modest levels of per capita income. This puts enormous pressure on countries like India, and Bangladesh and Pakistan, right next door to China, in which people are starving every day.

Thus political economists generally reject the capitalist model of development. They would focus their attention on alternative institutions and strategies. One alternative which impresses many political economists is the socialist model being developed in China. Other political economists would look to some of the growth and equity approaches outlined in the final section of this paper.

Recall once again that the goal is defined as liberation with the provision of basic needs and then the satisfaction of social needs. Since the institutional structures and the relation with technology in underdeveloped countries hamper the attainment of that goal, they must be changed. There is a wide variety of approaches to such institutional change, ranging from electoral politics (the overthrow of Allende has virtually discredited this approach) to violent revolution. In addition, there are a variety of forms the resultant society might take: a highly decentralized socialist confederation, a grouping of worker managed farms and enterprises, or a more democratic state socialism. The exact form must emerge from the experience and desires of given populations.

IV. The Socialist Model: China

While it should be emphasized that no one national model can represent the political economy paradigm, the efforts and attainments of China demand recognition, and in them, aspects of the model will be highlighted.

Institutions

First, instead of private ownership of the means of production, there must be social ownership of the means of production. Capital and land must be owned socially, for society must be able to capture the profits, the rent, and the interest that would be paid to the landlords and the capitalists. The society can then plow back the social surplus, instead of letting it go to the elite who are using it to consume luxury goods and to maintain the status quo. China has developed a number of mechanisms in both industry and agriculture to ensure social control of the surplus.

Secondly, instead of markets, there must be planning. Central planning is needed to allocate the factors of production, i.e., to allocate the land, labor, and capital, and to direct the social surplus into productive investments which meet people's basic needs. This is not the planning in a semi-capitalist economy which is basically a front for ruling class desires. Rather, it is planning which will generate the basic material goods to satisfy society's needs. China has combined central planning for the overall operation of the economy with decentralized and self-reliant activity in many areas.

Strategies

In terms of particular strategies, the first Chinese strategy that political economists are impressed by is its rural-based development, taking industry and the amenities of life out to the countryside, rather than letting all the people rush into the cities where they face slums, a high crime rate, high unemployment rate, etc.

Keeping people in the country, and bringing in industry of a labor-intensive kind has had two results. It has provided for full employment, and secondly, it has provided for a relatively equal distribution of income. Some studies of China tend to show that it has one of the most equal distributions of income of the poor countries of the world. So, political economists are impressed with this rural-based development, using labor-intensive technology. We will find that some growth and equity theorists suggest the same strategy. The question is whether the institutions that have thwarted other efforts will permit such a program to succeed in a capitalist country.

Another innovation, beside rural-based development and labor-intensive technology, is the strategy of mobilizing the people and the ability to get the bureaucrats, the people who work in the system, to relate in meaningful fashion to the people in a way which helps the people meet their basic needs. This is unique. There is no other socialist country in which this happens: the bureaucrats and the peasants in Russia are just as antagonistic as the bureaucrats and the peasants in India. But in China, apparently, there is somewhat of a symbiotic relationship. The explanation offered for this is the long Civil War, in which the Communist Party had to maintain the allegiance of the peasants and find ways of meeting their needs in order to keep them loyal.

The final aspect of note in the Chinese model is their willingness to reject the international economy as presently organized, to strive for self-reliance. Of course, most countries are not so large and diverse and rich in resources. But their example is a challenge to the present international structure. China has some severe problems in addition to its substantial attainments. Many of these are brought out by Peter Berger, who emphasizes the political costs (lack of citizen sovereignty). But the many successful aspects of the Chinese model indicate areas in which the political economy approach has a likelihood of success.

V. Growth With Equity

Three visions of development have dominated the work done in the area. The first is the traditional, conventional capitalist approach, which is pejoratively referred to today as the "trickle down" approach to development.

The second vision is that of the revolutionaries, the socialist or political economy vision.

The third vision is that of the neo-Malthusians who claim that development and growth are leading us to a bottomless pit, to an ecological Armageddon. They argue that neither capitalism nor socialism can deal with the fundamental problems facing humanity today.

There is a fourth vision. A new strategy for development is emerging which we call the "growth with equity" strategy. This strategy rejects all three of the competing visions in the world today.

It argues that the traditional capitalist approach will not trickle down to the poor. In fact, in poor countries today we find that the poor are absolutely worse off than they were before development began. We find increasing poverty, increasing income inequality, and increasing unemployment. So that vision is rejected.

Secondly, the revolutionary socialist vision is rejected. Revolutions are not likely in most less developed countries. Also, even if revolutions occur, it is not clear that they will lead to meeting the basic human needs of the people and expanding and guaranteeing human rights.

Finally, the neo-Malthusians' vision is rejected. People have the wit and the will to come up with new approaches to overcome the problems facing humanity today. We are not going to reach an ecological Armageddon.

But, the new strategy does draw from all three of the existing visions in the world. First of all, it employs the capitalist institutions from the traditional approach, and many of the examples come from Taiwan and Korea. Secondly, it borrows the egalitarianism of the socialist approach, and many examples come from mainland China, e.g., the idea of using barefoot doctors. Also, the new approach embodies some of the ideas of the neo-Malthusians. Advocates of the new strategy are convinced that there are limits to growth, that there really are ecological constraints facing us. They are very interested in intermediate technology. Many of the growth with equity strategies are advocates of Schumacher's Small is Beautiful.

The genesis of the new approach is a reexamination of the traditional approach carried out by writers who had previously been strong exponents of the grow now approach. Beginning in the late 1960's with the work of the Sussex group around Dudley Seers, Mahbub ul Haq at the World Bank, James Grant at the Overseas Development Council, Ted Owens at the U.S. Agency for International Development, the House Committee on International Relations, etc., a catalogue of failures of the accepted approach was begun; and in the period since then we have seen a variety of other failings being cited. Thus we have reached a situation in which the approach which had received widest acceptance now is openly questioned by some of its own founders.

Such questioning has resulted in a substantial reevaluation of the development experience in the post-war period. It is true that GNP per capita rose rapidly in most poor countries which followed the prescriptions of the 60's, but other indices of performance were changing as well, and in an opposite direction, indicating a deterioration in the lives of certain segments of the population.

One common theme runs through the noted failures of the traditional approach, and this is that the distribution of benefits in the process have been such as to benefit the poor little, if at all. Such a result offends any sense of justice, since it is the poor who face most directly the problem of basic survival. As might be expected, however, the traditional approach has not been abandoned, but a series of alternative strategies have recently been developed which hope to attack its failures. It should be noted that these new approaches are emerging amidst continued criticism both from within and without. We will turn to these critiques after examining the new approaches which purport to combine growth and equity. There are six variants presently discernible.

VI. The Six Models

All of the growth with equity approaches have certain aspects in common. All spring from a conviction that traditional reliance on growth of GNP will not benefit the poor in today's less developed countries or won't benefit them quickly enough

It is also generally accepted that social revolution is not in the cards for most poor countries in the near future. Thus, these theorists are struggling to come up with an approach that will achieve some degree of equity short of social revolution. They are convinced that the poor in capitalist less developed countries can improve their standard of living without revolution and they cite Taiwan, Korea, Hong Kong, Israel, Japan, Singapore, Costa Rica, and Sri Lanka as examples of countries where this has happened.

Another common factor is their implicit assumption concerning the peasants in less developed countries. They regard most people in the poor countries as responsive to economic opportunities; thus the bottleneck in the poor countries is not the peasant, but is more likely the powerful elite residing in the capital city who have failed to design projects which provide meaningful opportunities to peasants. Common explanations of this failure are: first, the people at the top don't understand the people at the local level and their needs; second, they have been following a development-from-above syndrome, keeping all the incentives, all the management, all the cash in the hands of the central planners; or finally, they have been following misguided economic policies, with price structures in most countries favoring the urban consumer, credit going to the wealthy, marketing and storage being unavailable to peasants, etc. Any effort at growth with equity must correct these inadequate economic policies.

Finally, these theorists all give considerable emphasis to the social and political variables in achieving growth and equity. They argue that one of the crucial limitations of past approaches was their narrow focus on simple economic factors - land, labor and capital - to the exclusion of political, social and cultural factors. They argue, in fact, that one of the reasons that there are different approaches today is because of different socio-political variables in different societies. So one approach may work in country A, and another approach may work in country B. Let us examine each of the approaches in turn.

i. Employment Generation/Appropriate Technology

The first to emerge was the employment generation approach which grew out of the International Labor Organization (ILO) missions which were sent to various countries -- Columbia, Kenya, Sri Lanka, etc. These missions discovered widespread and growing unemployment despite increases of Gross National Product. They also discovered what has come to be known as the informal sector, i.e., petty traders, retailers, carpenters, and so on, groups which had substantial entrepreneurial ability but whose main problem was a lack of capital. The ILO argued that the key to growth with equity was to switch emphasis from growth of GNP to emphasis on employment generation, and to do this partly through encouraging the informal sector and using intermediate or appropriate technology. Recent studies by Liedholm, et.al., in Africa confirm the ILO findings that small scale labor intensive industries are indeed efficient and profitable and mainly suffer from discriminatory interest charges for borrowed capital. This is, perhaps, the first empirical evidence that small is beautiful. From a slightly different vantage, an enormous literature has emerged on the use of appropriate technology. The gist of the argument is that past development efforts were hampered by the use of capital intensive technology imported from developed countries -- often as a result of foreign aid, or some other form of dependency relationship. The technology was associated with the West, with modernity, with efficiency, and thus was preferred to more profitable local technologies of a more labor-intensive nature. Studies by Wells and Thomas indicate such a situation.

Capital intensive technology created little employment and that was only for a local elite. Income from production went to capital owners and it thereby exacerbated the income distribution problem in these countries.

There are two approaches to dealing with this problem. The first which is represented most clearly by Schumacher and his Intermediate Technology group is that there must be concerted efforts to develop intermediate or appropriate technologies which can be incorporated in the development efforts of all countries, certainly including the underdeveloped countries.

Schumacher's case is a very strong one in favor of a technology which improves labor productivity, uses local resources, minimizes the use of non-renewable resources, and produces goods intended for local markets. It is in essence small-scale, self-help development.

This appeal has met with political support in the developed countries in part because intermediate technology is no threat to multinational corporations and is not designed to produce exports to compete with U.S. manufactured goods.

A second approach sees the problem of choice of technology in terms of the price signals to producers. They find a series of distortions which favor capital: over-valued exchange rates, government subsidies to capital, local minimum wage legislation or social service programs which raise the price of labor artificially, and interest rate policy which maintains artificially low interest rates. Thus they suggest that the manner of obtaining appropriate and labor-using technology is to remove these market distortions: maintain low wages, raise interest rates, and liberalize foreign exchange and tax policies. If these steps are taken, appropriate, labor-intensive technology will be chosen by profit-maximizing capitalists as happened after such reforms in Taiwan in the late 1950's. (Ranis) Changes in factor prices will also lead to a different choice of products tilting demand to more labor-intensive products. (Pack, 1974) As should be apparent, it is not always easy to distinguish this "prices right" group from the exponents of the traditional paradigm.

ii. <u>Redirecting Investment</u>

A second approach has been formulated by Chenery and separately by the ILO (in the Kenya report). In Chenery's formulation, emphasis is placed on the central role of capital formation. He argues that the poor must have greater capital in order to have the income which can meet their needs. Thus the policy thrust is toward a reorientation of capital formation away from large-scale centralized projects to types of investments which will relate directly to the poor; education, credit access, public facilities, etc. Command over this type of wealth will increase the productivity of the poor and thereby increase their income. In the short run this may come at the expense of growth; however, in the long run, the increased productivity and income of the poor will raise the incomes of all members of the society. Since even the well-off members of society will receive long run benefits from this "trickle up" strategy, they are not so likely to oppose it as they would a direct effort at asset redistribution.

If investment can be directed toward projects that are labor-intensive and which also meet basic human needs, over time there will be a significant improvement in the lot of the poor majority. This approach is spelled out in Chenery, et.al., Chapter 2. They also suggest there that the indicator of development be a weighted growth rate of income, where the income of the poor is given a greater weight.

iii. Meeting Basic Needs

The third approach can be termed the basic needs approach. Perhaps its first advocate was Mahbub ul Haq of the World Bank who referred to it as a direct attack on poverty. Another exponent of this approach is James Grant, President of the Overseas Development Council. Grant has built his case on the example of Sri Lanka, a country with a very low per capita income -- only $120 per year -- but which has been able to achieve rates of literacy, life expectancy, and infant mortality comparable to the United States in 1939: a life expectancy of 68 years, an infant mortality rate of 45 per 1,000, and a literacy rate of 76 per cent.

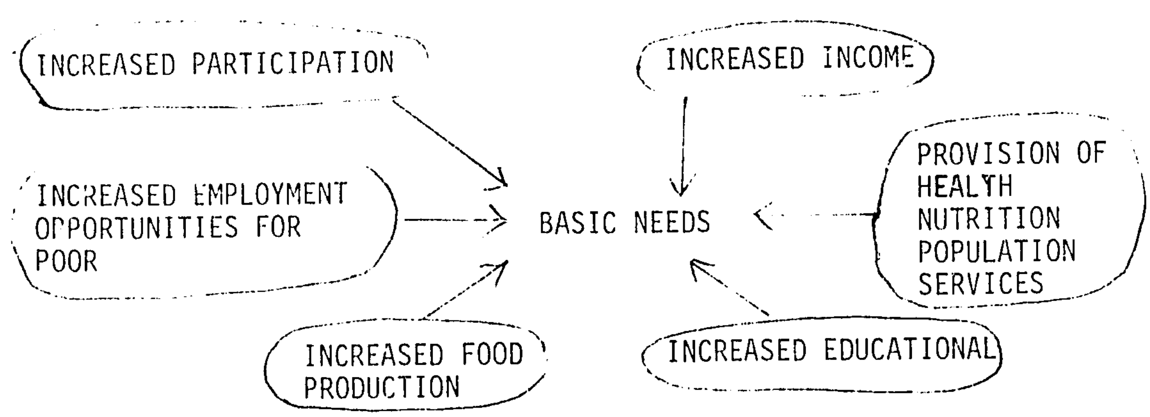
What policies have led to this success? One component is surely a free rice subsidy program -- 2-3 pounds of free rice distributed per week to everyone in Sri Lanka -- and low cost health and education delivery systems. This has resulted in a considerable redistribution of income in Sri Lanka, and it has been accomplished at a per capita cost of $14 per year. Grant argues that we could meet the needs of the world's poorest billion people -- the people living in absolute poverty -- for $14 billion a year. This would mean a doubling of foreign aid. Recently the International Labor Organization convention has adopted basic needs as the goal of development.

Paul Streeten and S.J. Burki have written a very persuasive article for the World Bank as to why basic needs should become the goal of development. They argue that the goal of development must be to meet the basic needs of every person born on the planet. These needs are: food specified in terms of calories -- specific by age, by sex, by occupation, by geographic region; potable water in reasonable proximity to people's houses; clothing and shelter which is adequate to the locality in which people live; medical care which includes preventive medicine, sanitation, health services, nutrition, population services; education which prepares people for more productive lives; participation in decision making; and increased human rights. They suggest that the basic needs approach be seen as an organizing principle around which systematically to organize our thinking and our efforts.

We must realize that the satisfaction of basic needs is a prerequisite for human life, a necessary precondition for human fulfillment. Once this goal has been defined, it becomes clearer how development efforts can be organized and oriented.

Of course the strategy for meeting basic needs is complex but we can now view the process of meeting basic needs as a system and can concentrate our efforts on the most important elements in that system. Diagrammatically, we can show this as below where each of the circles represents one of the crucial elements in meeting basic needs.

Figure VIII



All of these elements are important and no one of them in isolation will meet basic needs. Once we have identified the main elements involved in meeting basic needs, then each of these elements must be analyzed as a system, and the interrelationships among the elements must be understood. Many alternative strategies for affecting these elements can be chosen. These alternatives need to be analyzed and the most effective ones chosen. In so doing there are a number of important questions which must be dealt with:

-- Why not emphasize employment as the goal? Many people in LDC's are not only unemployed, they are unemployable -- the old, the sick, the disabled, children not part of households. These people will not be benefited by an employment approach, yet they have basic needs, too. The employment generation strategy is also deficient in that the problem is not really one of unemployment in poor countries. Only people who are fairly well-off can be unemployed in poor countries. The poor work all the time just to keep body and soul together. So the problem is not unemployment, it is unremunerative employment.

-- Why not emphasize increasing incomes as the goal? Many basic needs can only be supplied by the public sector -- sanitation, potable water, sewage, preventive medicine, education, etc. Increased income will not allow people to secure these services. In addition, people moving from subsistence to a money economy are not very capable consumers, especially in areas of nutrition and health. There are many examples of increased employment and incomes being accompanied by declining nutritional levels, e.g., reduction in breast feeding of infants.

But one fundamental argument for a basic needs approach as opposed to one which concentrates on raising income is that it can meet basic needs at much lower levels of per capita income than can reliance on raising incomes. Although the evidence is not clear, it appears that China, Sri Lanka, and Kerala have met basic needs at quite low levels of per capita income. So while redistribution with growth cannot be ignored, it acts entirely too slowly on basic needs to be the main element in this strategy. Redirecting one or two percent of the national income into investments to benefit the poor will raise the per capita income only $1 per year in countries with incomes less than two hundred dollars. Basic needs will not be met.

-- Won't services designed for the poor be hijacked by the rich? No doubt some of them will. There are examples of this everywhere in credit schemes for small farmers, education programs, etc. However, there are also some programs designed to benefit the poor which actually do reach the poor. This is one of the crucial problems in the basic needs approach -- how to design delivery systems that do reach the poor, and how to structure services so that the linkages of various services can be taken advantage of to achieve a synergistic effect.

-- Another very difficult question is the combination of centralization and decentralization which is best for meeting basic needs. If the program is not based on self-help and self-reliance, it becomes a welfare scheme and produces a welfare mentality and increased dependency. And yet if we wait on the poor to organize themselves to meet their basic needs we know we're going to have a very long wait. So there has to be a mix of outside intervention and local participation. We need to learn much more about how to bring this off.

-- How do we get governments to commit themselves to meet the basic needs of their people? This is not a problem unique to a basic needs approach, for all approaches to helping the poor face this. How do we get LDC governments to provide employment for the poor or to redistribute income to the poor? Is meeting the basic needs of the poor in the interest of elites? In some areas this is clearly the case, e.g., controlling communicable diseases. If all external assistance were tied to a basic needs approach, there would at least be an incentive to undertake such services. Nonetheless, this is a difficult political question and will be decided in each country. At the very least foreign assistance donors should not assist LDC governments which have not made a commitment to basic needs provision.

-- How do we measure performance in meeting basic needs? This is extremely difficult. LDC governments put up fences around their poverty. They don't want outsiders to see the extent of income inequality, hunger,squalor, disease, etc. William McGreevey has laid out the issues in measuring LDC performance very well in Annex D to USAID, Socio-Economic Performance Criteria for Development, 1977. Also,the Overseas Development Council has made a start toward measuring performance in the Physical Quality of Life Index (measuring infant mortality rates, life expectancy, and literacy) which has been published in Agenda, 1977. The PQLI is a very useful complement to per capita income and can be the basis for a better assessment of basic needs success. The gap between per capita incomes of the developed and developing countries grows each year and is depressing. However, if a basic needs approach is adopted, we would expect the PQLI of LDC's to move closer to those of developed countries.

-- What is the role for foreign assistance in meeting basic needs? Actually, USAID has been moving in this direction since the passage of the Foreign Assistance Act of 1973 and the World Bank and other foreign assistance agencies are considering meeting basic needs as the target for development.

Foreign assistance donors can make it clear that they will only assist LDC governments committed to meeting basic needs. They can help LDC's identify people living in poverty, help determine their priority needs, provide technical assistance and training in alternative delivery systems for meeting needs and can provide resources on a declining basis to fund the programs to meet basic needs.

The OEEC was set up jointly by the U.S. and Europe to allocate Marshall Plan funds and to measure performance in using those funds. Perhaps a similar organization could be set up in connection with a basic needs strategy.

iv. Human Resource Development

The fourth approach is the human resource development approach proposed by Irma Adelman. It, along with the next, requires land reform as a precondition for development. Adelman argues that a necessary starting point is redistribution of productive assets -- land and physical capital -- as occurred in Japan, Taiwan and Korea. Provision must also be made to ensure continued access to assets for the poor once the redistribution has taken place.

The next element of this strategy is a massive program to develop human resources as in South Korea. In 1964, the educational level of the Korean population was three times that of an average underdeveloped country at Korea's level of per capita GNP.

This emphasis on human capital creation will inevitably be accompanied by a decade or so of slow growth of GNP, resulting in social tension, unrest and political instability. Thus, the strategy calls for a strong government which can effectively deal with these problems.

Following the creation of human capital, countries must undertake a human resource intensive industrialization and growth program. Small countries will produce for the international market, while larger countries will produce labor and skill-intensive goods for their own domestic market. The high rate of employment generated by industrialization will provide the income which will lead to a demand for the goods produced and will ensure a wide distribution of benefits.

The final stages of this process require a rapid rate of growth. That is, once past the industrialization stage, countries must grow at five or six percent a year in order to attain equity.

There are problems with this approach. It is easy to call for a strong government that is devoted to redistribution of assets and to the interests of the poor. It is another thing to get that kind of a government. And a question that is increasingly important today is the likelihood of finding such a government that will also enhance, expand, and guarantee the human rights of her people.

It should be pointed out that the human resource strategy has brought to the forefront of thinking on development questions of the role of women. For it is ludicrous to think of such a strategy unless it incorporates this group which is most often disenfranchised despite its majority status.

v. Agricultural and Rural Development

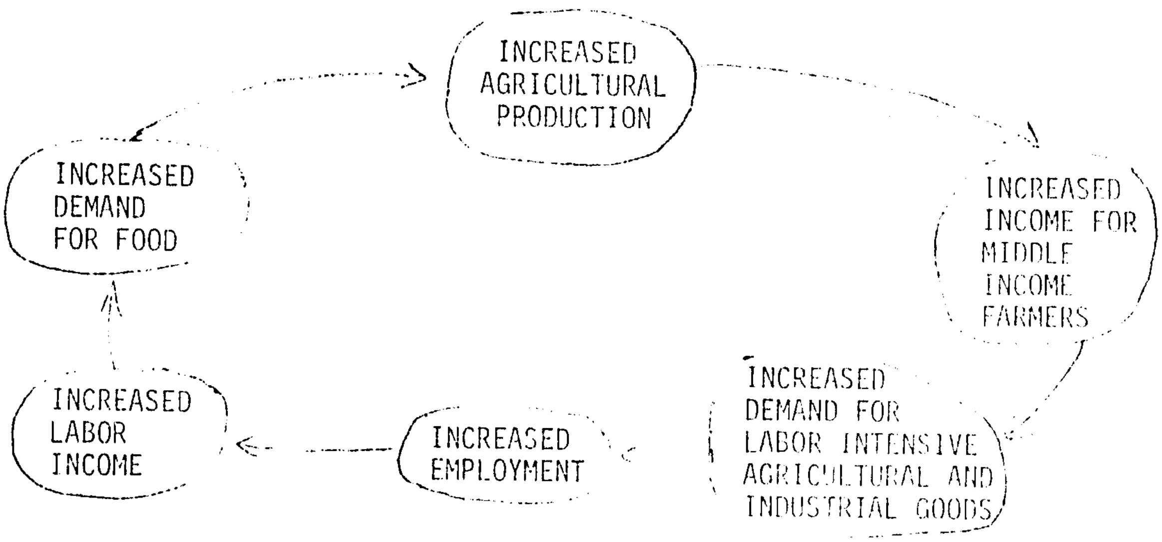
The fifth approach is the agricultural/rural development approach. John Mellor has outlined the case for the Agriculture First strategy in his book, The New Economics of Growth, and it resembles Adelman's in that it requires land reform before equitable growth can be achieved. It is based on the experience of the Punjab in India where agricultural development did lead to income redistribution and growth with equity.

Agriculture plays two roles: first it must supply, at a stable price, the wage goods which are necessary for employment creation. Low income people in LDC's spend the bulk of their income on agricultural goods. If their income increases, they will purchase more food and if output does not increase, this will result in substantial price increases for agricultural products. Wages would thus have to rise which would slow efforts to employ more people. So increases in agricultural production are essential to the success of this approach.

The second role of agriculture is to supply employment, seemingly a difficult task if agricultural prices are stable and low. Mellor suggests that the manner of accomplishing this is through technical change in agriculture, primarily biological research: new seeds, new fertilizer practices, irrigation, etc. Though the resultant increased output won't directly raise employment, the increased spending of farmers will. For example, in India, Mellor finds that rural spending out of additional income goes largely to agricultural goods produced in labor-intensive fashion. These farmers also buy labor-intensive goods from the industrial sector, i.e., textiles, bicycles, transistor radios, etc., products that are produced efficiently in small scale firms which could be located in rural areas, close to their new markets. Workers in these plants then buy the grain produced in the rural sector, and the entire process would generate employment and income.

So there would be a closed self-reinforcing system with no need for government intervention to regulate farm prices. This can be diagrammed as follows:

Figure IX



In addition to agricultural development there must be rural infrastructure to allow the system to operate. irrigation projects, farm to market roads, and so on. Such projects will generate employment and income for workers as well.

In order to carry out agricultural infrastructure development there must also be a significant degree of industrialization, e.g., cement and fertilizer production. So there are three components -- agricultural production, rural infrastructure and rural industrialization. In addition, Mellor urges that the less developed countries export labor-intensive goods to pay for the capital-intensive goods that they will need.

One of the problems with this approach is that it is so complex. It requires a high degree of coordination and control on the part of government. Some critics have also charged that it is a trickle down approach, the first beneficiaries are the middle income farmers and then the benefits trickle down to workers. People ask, "Why will trickle down work any better in agriculture than it did in industry?" (See Griffin)

A variation of the Agriculture First approach is the integrated rural development approach of Albert Waterston. He argues that if there is agricultural development only, as in the Green Revolution, the rich will reap the benefits for they can take advantage of the new technology and can afford the new seeds and the fertilizer. This would simply widen the gap between the rich and the poor. On the other hand, a basic needs approach which provides people with health care, education, food, etc., inculcates a welfare mentality and increased dependency. Waterston cites Sri Lanka and Tanzania as countries where services were provided to people thus slowing down growth since there is little incentive to produce. So he argues that these two components must be brought together in a program of integrated rural development with agricultural components, social infrastructure, and social services.

Waterston has analyzed hundreds of cases of rural development and he finds that there are six elements crucial for successful rural development which benefits the poor.

The first element is an agricultural technology which is not only yield-increasing but is also labor-intensive. This will not be as attractive to the large farmers but will be useful in increasing the incomes of the small farmers.

Secondly there must be minor development projects which use surplus labor in building schools, roads, dams, irrigation projects and so on. This generates employment and increases productivity in the rural sector.

The third component is rural small-scale industry. These industries are also labor-intensive and they can produce three types of goods. They can process agriculture products, e.g., canning factories and so on. They can provide the inputs needed for agriculture, such as mixing feed or fertilizer. Third, they can produce small consumer goods which can be marketed in the rural areas.

The fourth element which Waterston finds in all successful projects is self-reliance. People have to do it on their own. In fact he argues that there is a negative relationship between outside help and success. The more outside help the project gets the less likelihood there is of success.

The fifth element is a new form of governmental organization. If the line ministries -- health, agriculture, education, roads, communication, etc. -- run projects down in villages, there simply won't be successful rural development. There must be a local organization that has control over all of these aspects and is responsive to local people and their needs.

The sixth element is regional planning which undertakes to develop market towns, development centers and so on, which will process agriculture goods and will provide inputs for the villages. The gap between the village and the city must be bridged.

Waterston's approach is also quite complex organizationally. It is very difficult to conceive of bringing about this kind of organization at the local level that can carry out all of these functions. It requires a high degree of coordination on the part of government. It is also apparent that the possibility of asset redistribution is a key to the success of the last two approaches and differentiates them from the others. Thus this is an issue which must be faced.

vi. New International Economic Order

In addition to the five approaches emphasizing domestic transformation, there is a sixth and international approach to growth with equity. The international approach calls for a new international economic order and Mahbub ul Haq has made this case in The Third World and the International Economic Order. Haq argues that if we are going to have growth with equity, not only do we have to restructure the domestic economy, we also have to restructure the international economy, and it is here that the economic and political changes will most affect the U.S. It is not just a Third World problem but is a world problem.

The existing international economic order favors increasing inequalities between countries and increasing social imbalance within LDC's. These are linked phenomena. During the last 25 years per capita income more than doubled in the world, but it was concentrated in the hands of the developed countries and the priviled in LDC's. The mean per capita income in developed countries was on the order of 13 times the income in less developed countries in 1972 and was increasing approximately $120 per year. By way of contrast, per capita incomes in less developed countries were increasing about $7 per year. The present international economic order reveals that growth alone does not reduce underdevelopment. The majority of people in LDC's are still at the subsistence level and there are hundreds of millions of underemployed people in the urban zones.

Growth in developed countries during the last 20 years has led to increasing interdependency among them. In some developed countries more than 50% of industrial production goes to external markets so developed countries have high stakes in other developed countries. In the U.S., foreign earnings as a percentage of profits were 9% in 1950 and were 28% in 1969. In 1971 the largest 300 MNC's had 28% of world exports.

The developed countries also have high stakes in the less developed countries' economies. The most striking example is oil. Even the United States has demonstrated its inability to reduce its dependence on oil imported from less developed countries; and Western Europe and Japan are almost totally dependent on these countries for energy. Western Europe and Japan are also increasingly dependent on LDC's for the other natural resources necessary for industrial economies.

In addition the multinational corporations have come to play a substantial role in production activities in developed and developing countries. Indeed the current international economic order favors the increasing control by these firms of LDC economies, and it substantially hinders the ability of these countries to control their own economy.

This structural transformation of the world economy was not paralleled by increasing ability to stabilize national and international economies. So, there are two sets of problems behind the drive for a new international economic order.

-- Income has become more concentrated in the developed countries and among the elite in LDC's, and the international order has favored that process.

-- The ability to control domestic economies has been compromised substantially, especially in the case of the LDC facing large multinationals.

But the problems are linked and must be dealt with jointly. The process of development in LDC's is controlled increasingly by the multinational corporations and multinational banks. The instability in developed countries is also exacerbated by the absence of any mechanism to control the transnational enterprises.

The process of re-shaping the IEO is leading to a new structure of power in the world. New coalitions are emerging and the LDC's can no longer be ignored.

There are five bases for power in the international economy and they must be included in any program for a NIEO. First, there is control over markets. Governments of developed countries have the power to give access or deny access to their markets. MNC's also play a major role in controlling access to markets.

Second, there is control over finance. There has been a very rapid increase in world credit and the control over who gets credit is also a power weapon. The control of credit is in the hands of governments in the developed countries, the multinational banks, MNC's, the IMF and the OPEC countries.

The third source of power is control over technology. This is the most important source of power and is controlled by the MNC's. Singer has pointed out that 98% of research and development expenditures take place in developed countries.

The fourth source of power is control over non-renewable resources. This is the area in which we see a major re-shaping of the structure of power and new coalitions forming, and it is here where LDC's show their greatest strength.

The fifth source of power is human resources. These resources are becoming increasingly important as MNC's rely increasingly on the labor supplied by LDC's.

This is the background of the debate about re-shaping the international economic order. It is important to realize that the movement for a New International Economic Order (NIEO) is an historical movement succeeding the movement for political independence; it is a philosophical movement, a movement to re-shape the structure of power; a movement to control transnational enterprises in the interest of world stability; and a movement on the part of the LDC's to be treated as equals, to be involved, and to participate in international decision-making.

The most dramatic aspect of the OPEC agreement to raise the price of oil was the fact that this was the first time in history the LDC's made an important international economic decision unilaterally. The developed countries weren't consulted. The developed countries weren't involved.

What policy should the developed countries follow in re-shaping the IEO in the face of this structural transformation and the growth of this movement? They should accept a redistribution of international credit. Today 70% of the world's population in LDC's get 4% of the international liquidity (SDR's) created in the IMF but this formula must be altered to channel more international credit to LDC's in the future so that they can make it on their own. An analogy can be made to programs in the U.S. to channel credit to small farmers (the Farmers' Home Administration) or small business (the Small Business Administration). The same principle should be applied internationally.

International financial and technical assistance should encourage LDC's to process, transport, insure, and distribute their own products. At the present time, LDC's get $30 billion each year for their exports which are sold in the developed countries for $200 billion. The $170 billion difference goes to the middleman who processes, ships, transports, insures, and distributes these goods in the developed countries. If more of these services were provided by less expensive labor in LDC's, not only would the value-added in LDC's rise, but the final price paid by the consumer in developed countries might actually fall.

Developed countries should move vigorously to reduce tariffs and quotas on labor intensive goods which can be produced much more cheaply in LDC's. Again, this results in increased income in LDC's and lower prices for consumers in developed countries. The problems of course, come from the dislocation caused the workers in affected industries. Developed country governments must take an active role in assisting these industries.

Developed countries should greatly increase the amount of foreign assistance going to LDC's. This foreign assistance should be seen as an obligation -- not as an act of charity. In this regard they should support moves toward some form of international taxation, e.g., on the seabeds, non-renewable resources, etc. The revenue generated from international taxation should clearly go to those governments which have committed themselves to meeting the basic needs of their citizens.

Developed countries should accept a larger role for the LDC's in international economic decision-making. At the present time, 70% of the world's population lives in LDC's and has less than one-third of the votes in the IMF and IBRD. A larger voice for the LDC's is clearly in order -- commensurate with their increasing importance in the international economy.

With these changes, Haq sees the international sphere coming to play a more positive role in development and one which may actually facilitate growth and equity.

VII. The Critiques of Growth and Equity

The proliferation of approaches to growth with equity is matched by a multiplicity of critiques emanating on the one hand from defenders of the traditional approach and on the other from exponents of revolutionary approaches. It will be useful to take them in turn.

i. Traditional Critique

Three main components of the defense of the traditional approach are central. The first directly disputes the validity of the data which purport to show the failure of traditional efforts. The data are simply not adequate to reach any conclusions, there are no incontrovertible data to prove absolute worsening of living standards of the poor. Also, unemployment data in the Third World are meaningless, for many people have jobs which do not fit our definitions but which serve to provide them a livelihood. Finally, even the observations of growing relative inequality in countries such as Brazil are not unambiguous, and their interpretation is less so, since such changes may be short lived.

Secondly, traditionalists argue that attempts at rural development and keeping people in rural areas are reactionary, for history tells us that the source of dynamism and of hope for higher standards of living for the poor is urbanization and industrialization. It can also be shown that small farmer agriculture is not an efficient way to increase food production. While small farmers may be more efficient on a per acre basis, this overlooks the broader social cost of providing them inputs and distribution facilities, for it is clearly more costly to deliver fertilizer to 100 small farmers than to one large farmer. Also, from the urban side, studies of urban migrants have shown that they feel better off in cities than in the countryside. They have access to services, to health care, and to education. This adds plausibility to the argument that you cannot keep people in rural areas except through force and coercion.

The third and most important point is that the traditional approach to development is working, but is simply being judged too soon. Western European development exhibited exactly the same problems that Brazil is being criticized for today. There were high unemployment rates, since there were large numbers of people to absorb as a result of mechanization; and there was a temporary worsening of the income distribution. But in the long run, industrialization brought benefits to all the people in the society through jobs and resulting higher incomes.

Brazil is the most cited example of the success of the traditional approach. In the seven years, 1968 - 1974, Brazil's growth rate of 10% per year allowed it to double its GNP. Much of this growth came about through industrial expansion, and much of it was engendered by an active export promotion program. While such changes had their greatest effect on the well-being of the owners of capital, those with technical skills, or perhaps the military, the poor also benefited from the increase in the number of jobs in the economy. Although real wages certainly did not rise and demonstrably fell in certain periods of the "miracle", the increase in the number of jobs is claimed to counterbalance this for the poor as a whole. The same beneficial impact on family income is claimed to have occurred as a result of higher labor force participation in families.

The success is more general than just Brazil, for the benefits are everywhere trickling down. One example is health care. Malaria and small pox prevention programs have been widely effective in rural areas in underdeveloped countries. The falling infant mortality rates in underdeveloped countries are prima facie evidence that health benefits are reaching the people; e.g., in Latin America there was a drop in infant mortality from 120 per thousand to 60 per thousand during the last 30 years. That is obvious evidence that the poor are benefiting from the development process.

Additional support comes from comparing a country like Costa Rica, which followed the traditional growth strategy, with Cuba, which looked to equity. Between 1960 and 1974, Costa Rica lowered infant mortality rates more dramatically than Cuba; in education it attained a greater percentage increase in enrollments at the primary level, similar increases at the secondary level, and more than double the increase at the post-secondary level. In addition, GNP per capita in Cuba was almost constant throughout the period, and though Costa Rica had a per capita income $150 below Cuba in 1960, by 1974 it was $110 above Cuba.

So what is the answer to the problem of poverty and unemployment according to the traditionalists? The answer lies in more rapid growth of GNP; more use of multi-national corporations with their technology, their marketing skills, their managerial skills, etc.; more use of agri-business to come in and show new techniques, new ways of organizing agriculture; and more emphasis on export promotion. There must be a strong government to be able to discipline trade unions and keep wages from rising excessively and to allow profits to rise so they can be reinvested and plowed back into increasing economic activity.

Finally, these countries have to get their prices right. As was seen in the treatment of appropriate technology in almost all poor countries, prices are very distorted. Labor costs are too high because of trade unions, minimum wage legislation, and high government salaries. At the same time, capital costs are kept too low as the result of legislation keeping interest rates down. So manufacturers substitute capital for labor. In addition in almost all poor countries the foreign exchange rate is overvalued which encourages industrialists to import capital intensive goods. Also, farm prices are almost always kept too low in order to subsidize urban consumers with cheap food. This removes any incentive for farmers to produce more.

The answer to these problems is to allow the market to set prices.

Traditionalists cite Taiwan and Korea as examples of countries which adopted this mix of policies and which attained equitable growth using appropriate technologies once markets were allowed to operate.

The traditional approach is the only approach that has worked over time. The answer to growing unemployment, growing income inequality and growing poverty, according to the traditionalists, is more of the same strategy they have been advocating for the last two decades.

ii. Revolutionary Critique

Turning now to the left, to the revolutionary critics of growth and equity, there is again a healthy skepticism, but for very different reasons. As a starting point, it is claimed that poverty groups in Third World countries will benefit very little from a New International Economic Order. South Asia, where much of the world's poverty is concentrated, has a very low portion of its GNP related to foreign trade, in some cases as little as 5%. Thus, even with a new international economic order, there would be little impact on poverty. In addition, in the absence of changes in the class structure of countries, a new international economic order would not benefit the masses of people in the poor countries. It would be used to buy arms and police protection to keep their regimes in power or to invest in the United States and Western Europe.

The call for a new international economic order is essentially a sham. It's a device which the leaders of poor countries use to put the blame on the rich countries for the poverty of their people.

So we need a new international economic order, but that is not enough; for much of the problem is within the poor countries themselves. They are integrated social, political, economic, historical units, with a certain power structure which is benefitting from the existing system. Thus changes solely in the economic conditions will not be decisive. Even in the very poorest countries in the world -- Chad or Mali or Bangladesh -- there are very rich people, and thus the minor technical changes which the growth and equity strategists advocate do not deal with the basic problem. A slight change in agriculture or a slight change in rural development will have no effect in bringing about a change in society. Class structure can't be ignored.

The growth and equity theory argues that governments in poor countries want to bring about development, but this ignores the reality that elites find the present system to their liking; poverty serves a purpose.

Technical changes to raise growth rates will not have a meaningful impact on equity. Stronger reformist policies will also be ineffectual.

With regard to the models which require equitable land reform, it is highly unlikely that land reform will be carried out. Elites know that land reform will destroy the base of their power and their positions of privilege and will establish new classes in the society which will become the dominant groups. As Arun Shourie points out, threatening the elites with revolutions if they don't reform the land is like asking them to commit suicide lest they be killed. It won't work in underdeveloped countries any more than it would work internationally. One could make just as strong a case for international land reform as for land reform in India. And yet no one expects that threats, arguments or logic will convince the U.S., the Soviet Union or Australia, who dominate the world land mass despite their small populations, to bring about international land reform; they are not going to allow free migration to their lands. Neither will land reform be brought about in countries by appeals to elites or by threats.

In addition, there are no really new formulations or new ideas in the growth and equity approaches. All of them were encapsulated in the second five-year plan in India. New ways of putting old arguments are not going to change the way things are done in poor countries or internationally. The elites will build loopholes into any plan proposed and they will hold onto their wealth and power.

For this same reason, it is not possible to use government taxation and expenditures to redistribute income. This will antagonize the capitalist class and will lead to a strike of capital as happened in Chile. The results of a strike of capital will be economic chaos, stagnation in the economy and, ultimately, the overthrow of a reformist government.

The middle class will not support a Growth with Equity strategy, either. They want university educations for their children, they want cars.

The Growth with Equity strategists talk about bicycles and universal primary education, but the middle class will not support this.

Taiwan and Korea are not really models for less developed countries for many reasons. They received an enormous inflow of foreign aid. There is no way the rest of the world is going to receive aid on that scale. They did have social transformations in those countries. There was a massive redistribution of land taken away from the Japanese. And finally, they were export-led models of development. Those countries developed by exporting their asparagus and their mushrooms, etc. to the United States and Western Europe. There is no way that all of the countries in the world can develop with an export-led model for the U.S. could not buy all the goods that they would send. We would be up to our elbows in mushrooms.

The argument in favor of intermediate technology in poor countries will simply condemn these people to be hewers of wood and drawers of water in perpetuity. Real development requires adoption of the most technologically dynamic industry at the time as the engine of growth or leading sector. For instance England developed using textiles as the leading industry. Germany used chemicals and Japan used electronics. A case can be made for dual technology -- capital intensive in some sectors and labor intensive in others as in China today. But this is not the message carried by the intermediate technology crowd.

Finally, it is very significant that virtually all of these Growth with Equity strategists come from the West, from the United States or Great Britain. These strategies have not come from within the poor countries themselves. This is another Western export, designed to keep them poor forever; another example of cultural imperialism.

What is the answer according to the Left? The answer is social revolution. It can't be done through parliamentary means. What is involved is a long struggle of the masses to take power for themselves. The way to get land reform is to arm the peasants, something which cannot be done for them by the Communist party or the army. The people must realize that they are powerful and the elite is weak; the people are many, but the elite are few. At the height of British rule in the subcontinent of India they ruled 400 million people with 4000 British troops. You can only keep people immobilized if they are apathetic, passive, and uninformed. But an aroused and conscious people will throw off their fetters and be able to bring about development for themselves.

So the job of development, according to the left, is not to preach nostrums about growth and equity to the rulers. The job is to mobilize the people in the poor countries and progressive people in the United States, so that the United States Government does not support repressive and reactionary regimes against the peoples' drive for liberation.

VIII. Conclusions

The dispute over growth and equity approaches to development occurs in two dimensions, among the various approaches and between growth and equity and the other theories of development. On some points, there is an emerging consensus within the growth and equity advocates.

There does seem to be agreement that the consumption levels of the poor must be maintained and improved; that some set of basic needs must be met. It is also apparent that much of the effort must occur in rural areas and that it must include a redirecting of investment resources to provide the poor with greater command over them. Beyond that there is no obvious agreement as to the specific steps to be taken, nor as to the trade-off which does or should exist between growth and equity. These will be issues of debate in the coming years.

There is agreement that growth is quite as important as equity. We have the striking case of Uruguay, a country that achieved a very high degree of equity -- the most equitable distribution of any country on the South American continent -- and failed to grow and was unable to make the transfer payments to keep the equity; and the whole system fell apart. So growth is important along with equity.

On the other dimension, the conflict between growth and equity and either the traditionalist or the revolutionary approaches, the issues are less likely to be resolved. Perhaps of greatest use would be an indication of the intellectual role of the growth and equity approaches. Whether correct or not, there is a growing feeling among the intellectual elite in developed and underdeveloped capitalist countries that the traditional approach is simply not working, especially in terms of helping the poor.

Secondly, it is impossible for intellectual elites in the capitalist countries such as the U.S. to support revolutionary alternatives, despite their own revolutionary beginnings. However, the recent victories have been on the socialist side, e.g. Vietnam, Laos, Cambodia, Angola, and Mozambique. Some new strategy had to be devised. Thus, growth and equity was inevitable, as an alternative to the discredited traditional approach. The growth and equity strategy has become the only option for U.S. AID, the World Bank and other donor agencies with capitalist backgrounds.

What we have before us today is the old "revolution versus evolution" controversy. The revolutionaries are quite convinced that there is no hope for the poor in less developed countries short of massive, sweeping social revolution. The evolutionists are not convinced that such revolutions would necessarily be the answer to the problems of the poor. The evidence on whether revolutions succeed in helping the poor, guaranteeing human rights, expanding human development, is certainly mixed, as any reading of the record of Russia, China, Cambodia, Mexico, Cuba, Bolivia, Algeria, etc. would show.

On the other side it is not clear that capitalist development leads to growth with equity. We have some countries that have had a great deal of growth without much equity. We have had other capitalist countries that have achieved a fair amount of equity, but not much growth. And then there are some -- very few capitalist countries -- that have achieved both growth and equity. But it is not clear that those countries most often cited -- Taiwan and Korea -- can or should be emulated. The lack of human rights in those countries is all too apparent.

Thus, there are ambiguities in any of the approaches. But we must meet the basic needs of all the people. There is something less than admirable about Western intellectuals who, writing in their book-lined studies, issue urgent calls for massive, sweeping revolution in less developed countries. There is even less to be admired in those Western intellectuals who insistently call for a continuation of the status quo which has done so well by them. There is, thus, a case for striking out and seeking an alternative that seeks growth and equity through new approaches to development.

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