POLICIES, PARADIGMS AND THE DEVELOPMENT DEBATE AT THE CLOSE OF THE TWENTIETH CENTURY

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NO.2 OCTOBER, 1993

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In a few years from now we will have reached the end of the twentieth century. A number of post-colonial societies, including India, will also be soon completing their first half century of planned economic development as independent nation states. It is, therefore, time to pause and take stock of what we have learned about the process of development.

The evolution of economic development theory during these past fifty years makes a fascinating study in the interaction of events and ideas. The 1950s and early 1960s have been described as the years of High Development Theory (Krugman 1992). It is interesting to note the historical circumstances immediately preceding this period. They give us a clue to the emergence of development economics within the short span of a few years as an exciting new branch of economic theory, characterised by a degree of self-confidence almost verging on brashness.

The Great Depression marked a major turning point in the progress of material conditions not only in the industrialised countries but also in large parts of the rest of the world. The countries of Latin America in particular had been strongly articulated with the industrialised countries through trade relations. They exported agricultural products and minerals and in return bought manufactured goods to meet consumption requirements at home since the growth of domestic industry had been limited. After 1929, the collapse of economic activities at the centre of world capitalism and the consequent steep decline in the terms of trade facing these raw material suppliers in the periphery led to huge losses of output and employment in these Latin American countries. The loss of foreign exchange earnings also made it impossible for them to

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* This is a revised version of the Dr. Vedagiri Shanmugasundaram Memorial Lecture delivered under the auspices of the Department of Economics at the University of Madras on 2nd March, 1993.

continue importing manufactured goods to meet their consumption requirements. As a consequence, governments in most of these countries had to engage in large scale economic intervention, partly to arrest the decline in prices and incomes in the primary producing sectors and partly to initiate import substituting industrialisation as it was no longer possible to meet domestic requirements through imports from abroad (Furtado 1976, Bagchi 1982).

Further north in the U.S.A. the vast programme of public works and other activities initiated by the government under the New Deal had turned the U.S. economy around from the depths of depression and high unemployment to a period of long recovery. Later public action under the Marshall Plan had helped to pull the countries of Western Europe out of the destruction and dislocation of the Second World War and launched them into what turned out to be the longest period of high growth in this century. Further east, the Soviet Union and its allies in eastern Europe were still perceived as being highly successful in catching up with the market economies of the West on the basis of an alternative command system and centralised planning.

It was a milieu in which market failures loomed large. Societies in the East as well as the West and in the North as well as the South embraced the idea of an interventionist state. It was against this background that economic theory witnessed the emergence of a new branch called the economics of development, characterised by the seminal contributions of Arthur Lewis (1954), Ragnar Nurkse (1952), Paul Rosenstein Rodan (1943), Richard Eckaus (1955) and many others. Their theories were very often cast in the language of the Marginalist tradition which had come to occupy the centre stage of economic theory. Thus in her review of development theory Bharadwaj (1991) described these contributions as belonging to the Neoclassical paradigm which she calls Demand Supply Equilibrium theory. At one level these theories were indeed cast in the mould of markets, prices and allocative efficiency. They were concerned with endowment rigidities, externalities, market imperfections and price distortions. The policy implication was that the government should intervene in order to 'get prices right'.

At another level, however, coming as it did in the shadow of Keynes (Toye 1987), this new literature of development economics quickly merged with the new post-Keynesian theories of accumulation, distribution and growth. The questions they asked and the answers they arrived at were however not entirely new. Arthur Lewis is undoubtedly the leading exponent of this branch of economics. His dualistic model and the strategic relationships which it identified had already been largely anticipated in Preobrazhensky's theory of Primitive Socialist Accumulation in the context of the Soviet industrialisation debate (Mundle 1981). Preobrazhensky in turn had drawn his ideas from the theory of Primitive Capitalist Accumulation in Marx's model of the process of the first industrial revolution in England (Preobrazhensky 1926, Marx 1894). Though he had a number of difficulties with some of Marx's propositions, Lewis himself explicitly recognised the classical roots of his theory. Thus, analytically the economic theory of development which emerged in the 1950s was really an extension of the surplus based theories which Chakravarty (1982) has described as the Marx-Schumpeter approach, as distinct from the Mill-Marshall approach.

In the sphere of economic policy this second layer of development theory provided the intellectual foundation for widespread government intervention, restriction of the market mechanism, and government controlled allocation of investment funds in accordance with a comprehensive economy wide plan of production. Indian planners like Mahalanobis, Pitambar Pant and Chakravarty were leading contributors to these exercises in development planning (Chakravarty 1987). Though at the formal analytical level, these exercises bore a resemblance to comprehensive planning based on material balancing in the Soviet economy, the policy instruments employed for implementing such plans in India and many of the other developing countries were quite different from those employed in the command economy of the Soviet Union. Nevertheless, the consequences of such widespread state intervention in the developing countries was, in a qualitative sense, not very different from that in the centrally planned economies. The differences have been more of degree rather than substance. They may not have been so severe as to lead to total collapse, as observed in the former USSR and other east-European countries. However, the adverse effects of such indiscriminate intervention have been quite severe as we know from our own experience here in India. These were once described by Finance Minister Singh in the following words:

> "....It ought to be pointed out that those who argue in favour of planning are implicitly assuming that the state is a custodian of public interest. In addition, they are also assuming that public authorities have on the whole superior information and knowledge of issues having a bearing on investment decisions.......It must be frankly admitted that in many developing countries these conditions are not always satisfied. It is futile to expect rationality or optimality of investment decisions in a situation in which those who control the machinery of the State use it for their personal or group aggrandizement. Where there is rampant corruption in public services, the information available to the public authorities is also likely to be fouled. It thus needs to be emphasised that successful planning assumes a high degree of integrity in public services and political leadership. In addition, the success of planning depends on the technical competence of the administrative machinery, its capacity to anticipate events and take necessary corrective action fast enough. For this purpose, among other things, it is essential that those who make crucial economic decisions should be secure enough to take a fairly long view of the economic processes. Political instability or insecurity of tenure can have a highly destabilising effect on the quality of economic decision making processes..."(Singh 1986).

Singh went on to describe in the same lecture the persistent failure of most public enterprises to generate surpluses, thereby placing the entire decision process under great pressure. He also refers to the inefficient licensing restrictions used to guide private investment, the quantitative restrictions on trade and the excessively high tariff barriers, all of which have led to unnecessary distortions, a high cost structure, the frittering away of scarce resources through inefficiencies in the system and the consequent shortage of resources for promoting rapid growth.

The above description could apply to a large number of developing countries which adopt a strategy and policy of development similar to ours and in this regard the Indian experience is fairly representative. The adverse experience of indiscriminate state intervention in these countries, combined with failure of the command system in centrally planned economies, led to a great deal of disillusionment with the development economics which had provided the theoretical underpinning for such policies and strategies. The conservative critique of development theory, led by Harry Johnson (1971), Bela Ballasa (1971), Peter Bauer (1972), In Little (1982), Deepak Lal (1983), and others now appeared to be a triumphant counter revolution. It was reinforced by a great deal of new theorising on the rent seeking behaviour of government agents (Krueger 1974) and the behaviour of government itself, which we may describe as the theory of government failure (Buchanan and Tullock 1962, Collander 1984, Olson 1982). By the beginning of the 1980s Albert Hirshman (1981), one of the pioneers of the field, was himself writing about the decline of development economics.

The conservative critique did not of course go unchallenged. In the domain of economic theory early development theorists like Arthur Lewis (1984) were writing about the continuing relevance of a theory which addressed itself to the **differentia specifica** of the developing countries. However, the main response came in the form of new developments in economic theory during the 1980s. Like the earlier Keynesian revolution, these new developments have appeared not on the basis of an alternative paradigm but as a challenge to the neoclassical paradigm from within. Important insights and new tools of analysis originating from the literature on Industrial Organisation have led to new theorems which have revolutionised both Public Economics and the theory of international trade.

Exceptions to the fundamental theorems of welfare economics had of course been recognised at least since the time of Pigou (1926). The existence of externalities call for some intervention by way of taxes or subsidies to make the choices of private agents consistent with social optima. The theory of public goods following Samuelson (1954) also established that in the case of some goods and services, characterised by non-competitiveness in consumption and non-excludability, public provision of such services would be necessary. Interventions were also called for in the case of natural monopolies. These, however, were seen as exceptions to the general principle that non-intervention with the market mechanism was the best policy.

In contrast the new results strike at the very roots of the theory that market outcomes are socially optimal. The two fundamental theorems of welfare economics maintained, first, that under certain conditions, which we may for convenience describe as an Arrow-Debreu world, market outcomes would be Pareto efficient and, second, that any Pareto efficient point on the utility possibility frontier could be attained through the market mechanism with an appropriate initial distribution of endowments between agents. However, the Arrow-Debreu world implies a set of highly restrictive conditions. The new results establish that once these restrictive assumptions are relaxed, the market efficiency theorems break down, i.e., if there are incomplete markets for risks or missing future markets or imperfect information, conditions which are fairly typical and general, the market solutions need not be Pareto optimal (Stiglitz 1992). Similarly, in the field of international economics the new strategic trade theory demonstrates that once we allow for increasing returns or market imperfections and the role of history (initial conditions), free trade would not in general be the optimal policy (Helpman and Krugman 1985). These results go far beyond earlier theorems on the possibility of factor intensity reversal, learning effects and Second Best Theory which allowed for some exceptions to the rule that free trade is the optimal policy.

This counter-counter-revolution in development theory (Krugman 1992) has been considerably reinforced by the dramatic success of countries like Japan, Korea, etc. which have been characterised by highly interventionist regimes (Okita 1980, Dutta Chaudhury 1981). The theory of government failure has obviously found it difficult to deal with this east-Asian experience.

These new developments in neoclassical theory have also seen parallel developments in alternative paradigms, in particular some strands of Marxist economic theory and Structuralist Theory which attempt to come to terms with the actual historical experience. As a consequence, some scholars have noted a tendency towards convergence of views across paradigms in the field of development theory (Bardhan 1988, Dutt 1992). The emerging consensus recognises elements of both Market Failure as well as Government Failure and focusses on questions about the condition under which one would outweigh the other.

In the realm of policy also there is a growing and healthy impatience with ideology driven prescriptions of either the interventionist variety or the free market variety. Competent policy advisors are now inclined to focus on the appropriate combination of markets and state intervention (World Bank 1991a, 1991b). It is now generally recognised that apart from maintaining macro economic stability, governments in developing countries must also strongly intervene in sectors like health care, education, development of physical infrastructure such as roads, transportation, power and communications as well as anti-poverty programmes and protection of the environment. Informed debate now focusses not on whether the government should intervene but on what forms of intervention would minimise the combination of both government failure and market failure such that social objectives can be achieved at minimum social cost.

There is probably less agreement on the question of industrial policy. Strategic trade theory establishes that Free Trade is not necessarily an optimal policy. However, there are as yet very few results by way of general principles as to what form of industry and trade policy may be optimal. Researchers in the intersection between theory and empirical experience are now searching for possible patterns and clues as to what makes for industrial success in the developing world. Attention has been focussed on issues of incentives, the development of capabilities and creation of appropriate institutions (Lall 1991). They have also focussed on the problems of coordination and information, dynamic comparative advantage and the choice of effective policy instruments such as strategic government financing of private investment (Dutta Chaudhury 1990, Bardhan 1991). One important inference now emerging is that in the field of industrial policy government intervention works best when it tends to support rather than supplant the market (Datta Chaudhury 1990).

The foregoing discussion has so far focussed on one major aspect of the development debate which has come to the fore in recent years, namely, the role of the state vis-a-vis the market. We may now briefly turn to two other important aspects of the development debate, namely, agriculture versus industry and import substitution versus export led growth. It is appropriate to discuss both these questions together because they are in fact two aspects of the same question.

The historical record shows that outwardly oriented economies tend to do well during a period of dynamism and high growth in the world economy whereas they are prone to severe dislocation and collapse during a downturn in international economic activity. Reference has been made earlier to the experience of the export oriented economies of Latin America where economic activity was severely disrupted leading to huge losses in output, employment and standards of living following the Great Depression of 1929 (Furtado 1970). Conversely we now have the dramatic experience of extremely successful export led growth in the economies of east Asia, riding on a great boom of world economic activity from the 1950s onwards. In other words, the question of whether a policy of export led growth is likely to succeed or not cannot be context free. When the tide of international trade is rising export led growth strategies are likely to work well. In a period of decline internally oriented economies are likely to be less damaged by the stagnation or slow down in world trade.

In any case, the perceived opposition between export led growth and a growth strategy focussing on the domestic market is probably misplaced, except in the case of primary producing countries where growth may be led exclusively by the export of minerals or agricultural products. Once we move beyond this narrow range of activities and consider the export of manufactures, or even the export of processed primary products after value addition, it will be evident that the export of these products would only be sustainable when comparative cost advantage is established. Typically, these are established only when there is prior development of an adequate production base on the basis of a home market. Thus, the real issue on the question of inward versus outward orientation is not a matter of comparing alternative strategies but establishing the appropriate sequences of a single strategy.

Seen from this perspective, it will evident that development policy cannot ignore the question of the home market, except under circumstances peculiar to primary exporters controlling strategic products, such as the oil exporting countries of the middle-East. Once this is recognised, it is not difficult to see that industrialisation can only be sustained on the basis of a prior or simultaneous revolution leading to sustained productivity increases in agriculture. This theme of a necessary balance between industry and agriculture is one of the early insights of classical political economy going at least as far back as Adam Smith (1776). It has been frequently restated during the past two centuries, most transparently by Arthur Lewis in his celebrated Janeway lecture on the Evolution of the International Economic Order (Lewis 1977).

In a closed economy, if other constraints are not binding, the size of the sustainable non-agricultural work force will be determined by the surplus of food production in agriculture over and above the requirements of the work force in agriculture. Hence the size of the work force in non-agricultural economic activities can grow, relative to that in agriculture, only when there is rising labour productivity in the agricultural sector. Similarly, in the presence of surplus labour, the operation of the labour market establishes a functional relationship between the floor real wages in the non-agricultural sector, hence the entire real wage structure of the sector and labour productivity in the agricultural sector. Over the long run therefore, standards of living in the economy as a whole will ultimately depend on the productivity of labour in agriculture.

It may appear that this balance is broken once the economy is opened up, since manufactures can then be traded with food produced in the rest of the world and that the industrial sector is freed from its dependence on domestic agriculture. In fact such independence appears only after an economy is sufficiently industrialised so as to establish its comparative cost advantage for some manufactured products vis-a-vis the rest of the world. However, it has been pointed out earlier that for this to happen there must be a prior development of industry based on the home market. Hence the relationship of balance between agriculture and industry which must exist in the context of a closed economy also operates in the early phases of industrialisation in the context of an open economy.

The necessary balance between agriculture and industry implies that industrialisation, even if it is of the export led variety in its later phases, has a prior dependence on the conditions which govern the progress of agriculture. These include not only the natural endowments of a country but also the technology employed in agriculture and the incentive structure of agrarian relations. It is one of the well established lessons of history that successful industrialisation has almost always been crucially dependent on the extent to which agrarian relations are conducive to the development of agriculture (Mundle 1985, Breman Mundle 1991).

Finally we may briefly refer to the relationship between democracy and development. In recent years there have been references to the proposition that in developing countries economic liberalism is not compatible with political liberalism or that there is a trade off between democracy and development. These propositions are of course not equivalent but they do suggest that a hard state is a necessary condition for development. This is a curious proposition since recent history is replete with examples of a disastrous development record in many countries under dictatorship or totalitarian rule in Latin America, Africa, Eastern Europe and the former Soviet Union, just as there are examples of successful economic performance under nondemocratic regimes, particularly in Asia.

In a recent discussion (World Bank 1991a) Amartya Sen argued that if the measure of development is broadened to include, besides per capita income, such indicators as the expectation of life, mortality, morbidity, literacy, etc. which reflect the development of human capability and well being, democracy may in fact be seen as a necessary condition for successful development. Clearly the notion of democracy in these two views are quite different. The democracy referred to by Sen is evidently democracy of the kind where there is grass root level empowerment of ordinary people within established democratic institutions and public opinion counts in determining public policy. The concept of "democracy" which is incompatible with development is presumably the pork barrel politics of special interest groups and coalitional politics. Under such regimes it is only the narrow but well organised social groups belonging to the ruling coalition who drive public policies (Olson 1982, Bardhan 1984). If there is a particular group with decisive power within the coalition, such a group may be able to enforce a viable development policy at some costs to the other groups and the rest of society in the short run. We then have a case of successful authoritarian development. Where no group within the coalition is sufficiently powerful to impose its will on the rest, we have a case of arrested development, trapped in a political gridlock (Mundle 1992).

At the end of the day what development requires is good governance and public intervention which supplements rather than supplants the market mechanism. This is not a new discovery. The principle had already been recognised by the author of the **Arthashastra** hundreds of years ago as one of the necessary conditions of successful state craft. Let us give the last word to Kautilya

> "In the interests of the prosperity of the country, the King should be diligent in foreseeing the possibilities of calamities, try to avoid them before they arrive, overcome those which happen, remove all obstructions to economic activity and prevent loss of revenue to the state." (Rangarajan 1992, p.116)

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