



The Significance of Development Economics

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Summary. — Development economics focuses on the elemental forces that raise per capita income. A key factor in this process is the growth-generating reallocation of labor and capital among sectors, an aspect missed completely by all versions of the neoclassical growth theory. The relevance of our discipline to development policy remains undiminished by a greater recognition of market forces and freer international trade to maximize social welfare. Development economics, however, needs to be guided by a consequentialist ethical philosophy to emphasize a fairer distribution of the fruits of economic progress both nationally and internationally; and, more generally, to promote human development. Copyright © 1996 Elsevier Science Ltd

1. INTRODUCTION

It has been asserted from time to time, mostly for ideological reasons, that development economics is not helpful for economic development. This must be contested to avoid confusion at the theoretical as well as policy-making levels. To this end, Lewis's (1984) definition of development economics, though somewhat incomplete, is quite apt: it is, according to him, "a subject which deals with the structural behaviour of economies where output per head is less than 1980 US\$ 2,000" (p. 1), which would be about 1994 US\$ 2,532. According to Lewis's definition, 59% of all countries of the world and 70.2% of the world population come under the writ of development economics. These include all the 42 low-income economies and as many as 31 lower middle-income economies — home to the majority of humankind.

Development economics seeks to isolate the elemental forces at work in developing countries that raise per capita income, initially and then continuously, by exploiting fully the interindustry and intersectoral network of economies of scale, externalities, and complementarities; it also analyzes the key factors that decide a fair distribution of the fruits of economic progress, and those which enhance human happiness more directly. The process of economic development, which includes economic growth as a subset, is seen as complex, even mysterious. It must be tackled by conscious planning where coordination failures are threatening, and through the market mechanism if information problems are daunting. In short, development economics remains to this day the sole exponent of economic development, which is the "foundational motivation of the subject of economics in general" (Sen, 1988, p. 11).

Yet, a persistent theme in economic literature has been one of denial of the (marginal) utility of development economics. Schultz (1981) maintains that development economics is redundant because "standard economic theory is as applicable to the scarcity problems that confront the low-income countries as to the corresponding problems of the high-income countries" (p. 4). Others condemn the inherent etatistic bias of development economics and its preoccupation with macro issues rather than micro issues, especially those related to "setting the relative prices right" (Bauer, 1972; Lal, 1983; Bell, 1990). Further, many economists see the success of the East Asian Tigers — which are claimed to have progressed the fastest because they opted to be outward-looking — as positive proof against the essentially protectionist and inward-looking development economics that has not been beneficial to developing countries (Bhagwati, 1989; Little, 1982). Essentially, most of these "arguments" are nothing more than a thinly disguised championing of the ideology of free-market capitalism as the ultimate truth about the economic universe (Heilbroner, 1990), and they are a frame of thought into which development economics would not fit naturally.

As one would expect, these views about development economics have not gone unchallenged — e.g., Lewis (1984); Stern (1989); Sen (1988); Bardhan (1993); Naqvi (1993). But the main issue is far from settled. I, therefore, restate the case for development

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economics in the light of some recent developments at the theoretical level as well as in the real world to question the orthodoxies of the day and to establish the relevance of our discipline to the problems facing the developing countries. I first examine the main explanations of the mainsprings of economic progress; and then go on to discuss issues related to the relationship between trade and growth and those concerning with achieving an optimal mix of the government and the market. Finally, I emphasize the need to acquire an ethical vision in order to identify the ends of economic progress and to order the means to achieve them. This by no means exhausts the list of issues that are relevant; for instance, I do not take up the important question of the ecological sustainability of economic development as it requires full-length treatment in its own right. But what I have to say is enough to illustrate the significance of development economics.

2. THE MAINSPRINGS OF ECONOMIC PROGRESS

I first discuss briefly an area where development economics enjoys a virtual monopoly — namely, in offering an adequate explanation of the nature of the development process and suggesting a viable strategy to achieve a high rate of economic development.

(a) *The character of economic development*

Development economics identifies four distinct, though related, dimensions of the process of economic development.

(i) *Stylized facts*

It seeks to identify the “stylized facts” or the “regularities” of the development process over time and across countries. This analysis is concerned with such matters as physical capital accumulation, industrialization, and a rising share of international trade (Lewis, 1954; Rostow, 1956; Kuznets, 1973; Chenery and Syrquin, 1975; Denison, 1962); and its main focus is on forces that enlarge the size of the market by large doses of investment to raise per capita income rapidly — through the Big Push (Rosenstein-Rodan, 1943), the Critical Minimum Effort (Leibenstein, 1957), and the Great Spurt (Gerschenkron, 1962). Lewis specifically states that the central problem in the theory of economic development is to increase the saving (investment) rate from 4 to 5% of national income to 12–15% of national income. Rostow explicitly stipulates doubling the rate of capital accumulation as the key to economic progress. Human capital, defined as the accumulation effort devoted to schooling and training, was added later to this exclusive list of styl-

ized facts (Schultz, 1961; Scitovsky, 1987). The positive role of total factor productivity (TFP) — that ill-measured variable discovered by Denison’s growth accounting — features prominently in the pioneer-latecomer catching-up sequencing of the development process (Gerschenkron, 1962; Amsden, 1989); and, of late, it has been emphasized in the literature explaining the East Asian “miracle” (e.g., Lucas, 1993). But care has been taken in the development literature not to underemphasize the centrality of physical and human capital formation, especially of the investment in equipment and machines, which “embody” technological change (Mahalanobis, 1953; Bradford, Long, and Summers, 1991).¹

(ii) *Structural transformation*

A related factor of economic development is the secular change in the sectoral composition of production — which is known as “structural transformation,” and is indicated by the rising share of manufacturing and a corresponding decline in the share of agriculture in total employment and the GNP (Kuznets, 1966; Chenery and Syrquin, 1986). Such a historical pattern was captured earlier in the justly famous two-sector model of growth (Clark, 1940; Nelson, 1956; Lewis, 1954; Fei and Ranis, 1963), where capital and labor move unidirectionally from a low-productivity agriculture to a high-productivity industry, where economies of scale and complementarities typically characterize the production process. This structural shift, helped by Engel’s Law and powered by an unchanged agricultural wage rate, accelerates the process of income generation because capital accumulation is higher in manufacturing than in agriculture. This can be referred to as the Fundamental Law of Economic Development.

(iii) *Economy-wide dimensions*

One main theme of development economics, which is related to (b), has been to see economic development as a wider phenomenon involving transformation of the structure of demand, trade, production, and employment, together with the accumulation of physical and human capital (Chenery and Srinivasan, 1988). The earlier theses of “balanced growth” (Nurkse, 1953) and “unbalanced growth” (Hirschman, 1958; Streeten, 1959) reflect the same conceptualization of the economy-wide dimensions of the process of economic development. Similarly motivated are the investigations that deal with the effects of economic development on income distribution, unemployment, and poverty (Lewis, 1954; Kuznets, 1955; Adelman and Morris, 1973; Ahluwalia, 1976; Harris-Todaro, 1970); and also those explorations which interpret economic development as one that keeps a dynamic balance between income, life expectancy, and literacy, so that it also fosters “human development” (UNDP, 1990; Streeten, 1994).

(iv) *Experience of the high-growth economies*

Another important observation about the nature of the development process is based on the experience of the high-growth economies (especially those of East Asia). A high rate of economic growth of per capita income in excess of 3%, helped by very high rates of physical and human capital accumulation and fast growth rates of TPF, has a favorable effect on income distribution; it also helps reduce poverty (World Bank, 1993). Generalizing from the development experiences of 40 developing countries belonging to Asia, Africa, and Latin America, I have shown elsewhere that economic development is characterized by an essentially "orderly transformation" of the fast-developing countries to higher stages of economic development — that, in these countries, the growth of per capita income, macroeconomic stability, and distributive justice tend to move together in a reinforcing fashion. Moreover, the human development indicators register the fastest improvement in such conditions. Contrariwise,

the developing countries suffering from low growth of per capita income are generally worse off with respect to macro-economic stability and distributive justice as compared to those enjoying medium growth and high growth (Naqvi, 1995, p. 549).

(b) *Rival (neoclassical) Explanations*

The earliest models of economic development, including the Lewis two-sector model, were inspired by the key insights provided by the Harrod (1939) and Domar (1957) model, which identified the saving rate, the capital/output ratio, and the growth rate of labor force as the key growth-promoting factors. In this formulation, human capital appears as effective labor input. To this short list of variables, Solow (1957) added (exogenous) technological change as a central propeller of economic growth. These growth models have been engrossed full-time in explaining the general-equilibrium configurations of the level of per capita income along the steady-state path. A central prediction of this class of growth theories is that, given a constant capital/output ratio and an initial (low) capital/labor ratio, a relatively poor economy will have a high marginal product of capital which will trigger greater savings and new investment at an early stage of economic development. This will, however, eventually lead to a falling rate of return on investment (savings) on account of the diminishing returns on capital. The economy will, therefore, fall back to steady-state, with the size of the investment and saving activity being just enough to replace worn-out machines and equip new workers. Applied to cross-country growth experience, there will thus be a tendency toward "convergence" in the levels of per capita

income across the poor and rich countries. Solow showed, however, that technological change, augmenting productivity at a constant rate, may prevent the marginal product of capital from declining for some time, but not indefinitely.

Of late, the "endogenous growth theory" has sought to extend the neoclassical model to identify the forces that raise per capita income indefinitely (Romer, 1986; Lucas, 1988). In this conceptualization, technological change is not exogenously given; and there are no diminishing returns to capital, but the capital/output ratio is still assumed to remain constant. The new literature explicitly recognizes human capital to be as important as physical capital, especially because it is a key input in the research activity, which eventually leads to greater (private) research and development (R&D) expenditure and generates new products and ideas that help (endogenous) technological progress (Romer, 1990). An implication of this theory is that the rich countries get richer as a high rate of investment accelerates growth because of strong external economies, and/or because it improves the quality of machinery or other intermediate inputs used in the production process. This nonconvergence between the wealth of nations shows up in the persistence of wage differentials between different countries and the patterns of international migration — which also suggests that the same technology is not available to all countries as the neoclassical model postulates.

Notwithstanding its solid theoretical achievements, it would be a mistake, however, to see the endogenous growth theory as having replaced development economics. This is because the former makes extremely stringent assumptions about international production functions and assumes a single sector, or that all sectors are symmetrical in nature.² As a result, it fails to highlight the growth-generating reallocation of labor (and capital) among the sectors associated with the process of structural transformation. In addition, the empirical tests of the endogenous growth theory seem

altogether too vulnerable to bias from omitted variables, to reverse causation, and above all to the recurrent suspicion that the experiences of very different national economies are not to be explained as if they represented different "points" on some well-defined surface (Solow, 1994, p. 51).

The main prediction about the nonconvergence of the developed and the developing countries does not hold true universally. In the last 40 years or so, a convergence has occurred between the per capita incomes of the fast-developing countries such as Japan and South Korea, on the one hand, and the developed Western Europe and the United States, on the other (World Bank, 1993; and the same is going to happen

in the case of China, Hong Kong, and Singapore by the end of this century. Barro and Lee (1993) show that convergence occurs when per capita incomes grow in excess of 3.1%. For all these reasons, the new theory fails to provide "a powerful organising framework for thinking about actual growth phenomenon" (Pack, 1994, p. 55), much less explain the wider phenomenon of economic development.

3. TRADE AND GROWTH

The relationship between freer trade and a higher growth rate of the GDP has also been cited to demolish the claim of development economics to a distinctive place in the economic universe. It has been asserted, for instance, that countries practicing import-substitution industrialization (ISI) scored only low or moderate growth rates — dispirited as they were by the pessimistic Singer (1950) and Prebisch (1950) hypothesis about a secular deterioration in the prices of the primary goods which combined with low income and price elasticities of demand for such goods and the raw material-saving nature of technological change in developed countries. On the other hand, the HPAEs (High-performing Asian economies), allegedly guided by a free market ideology, practiced an export-push strategy and reaped incomparably higher growth rates of per capita income. The HPAE performance led to the conclusion that the free-trade prescription of neoclassical (and classical) economics should be trusted more than the protectionist proclivities of development economics in the design of development policy. But such generalization is unwarranted, both factually and logically. It is factually wrong, because the HPAEs have continued to practice efficient import-substitution industrialization by "picking winners" — indeed by "creating winners" in the public sector, who, in turn, "crowd-in" additional private investment (Streeten, 1993). It is also logically false because a concern about the fairness of the distribution of gains from trade and investment does not amount to asserting that "the deteriorating barter terms of trade must of necessity impose a welfare loss on developing countries" (Singer, 1984, p. 284). The fact of the matter is that in a dynamic setting both import substitution and export expansion become necessary, with the former usually preceding the latter and "laying the foundations for successful export performance" (Streeten, 1985, p. 58). Thus a rational development policy would not choose between these strategies "since each must be taken to the margin of advantage" to maximize industrial growth (Lewis, 1984b, p. 122). The reason why the HPAEs have done incomparably better than other developing countries is more basic: it was their capacity to see clearly and promptly this "margin of advantage" when the time came; and because they have

shown an uncommon resilience in adjusting domestic policies to external shocks, and in taking advantage of the possibilities of gains from foreign trade during periods of a strong external demand for exports.

But regardless of its logical and factual weaknesses, a large literature has mushroomed around two basic propositions: (a) Trade liberalization strategies are unambiguously superior to protectionist regimes because they promote higher rates of export growth, (b) and because higher exports are positively related to a higher growth rate of the GDP.

We must therefore discuss these propositions.

It has been asserted that protectionist regimes produce inefficient industrialization — they entail high effective rates of protection (Little, Scitovsky, and Scott, 1970; Balassa, 1971), impose high domestic resource cost (Krueger, 1974), and, for these reasons, lead to a reduction in savings, a lower rate of capacity utilization, a worsened income distribution, and a higher rate of unemployment. In sharp contrast, trade liberalization leads to greater exports (Bhagwati, 1978) and lower unemployment (Krueger, 1978; Balassa, 1982). But, as Edwards (1993) points out, the evidence on this score does not seem to be entirely free of ambiguity, either because of the authors' inability to define clearly as to what exactly is meant by alternative policies and by trade reforms, or because the choice of the liberalization index has been largely subjective, or even worse, because the superiority of trade liberalization has been simply asserted on ideological grounds rather than proved empirically. It is, therefore, no wonder that Sachs (1987) questions the premise that trade liberalization leads to outward-oriented strategies; and Taylor (1988) argues that there are no greater benefits (in fact there is some loss) "in following open trade and capital market strategies" (p. 141).

The proposition that greater exports lead to a higher GDP growth has also been asserted and questioned. Thus, for instance, Michaely (1977) and Balassa (1978) report a significant correlation between the rate of growth of export shares of the GDP and the growth of per capita income. But, as we know, a significant correlation between exports and GDP growth does not decide the issue of causation — is it the faster GDP growth that causes greater exports or is it the other way round? Indeed, it can be shown that greater export orientation — when the effective exchange rate for exports (EER_x) is strictly greater than the effective exchange rate for imports (EER_m) — may not necessarily be growth-promoting and welfare-raising in the long run for the developing countries. For instance, specialization in the production of goods which are relatively intensive in the use of abundant unskilled labor and natural resources (as the Heckscher-Ohlin Theorem would advise) may come about at the expense of those activities which are intensive in human capital and R&D and are eventu-

ally more growth-promoting (Grossman and Helpman, 1994). Some protection to R&D-intensive activities may, therefore, be an optimal policy. These arguments do not, however, deny that greater exports lead to higher growth; it is rather that "Outward orientation cannot be considered as a universal recommendation for all conditions and for all types of countries" (Singer and Gray, 1988, p. 403).

At this point, it is interesting to discuss briefly the relevance of the multifaceted Uruguay Round (UR) Agreement, which formally came into force on January 1, 1995 and must be accepted as an irreducible package by all signatories (both the developed and the developing countries), to the trade-and-growth debate.

First, the issues relating to the unequal distribution of gains from trade and investment, a persistent theme since the beginning of the development economics literature, will be no less important in the post-UR world than in the period before. A preliminary estimate of the gains from greater trade due to the UR Agreement clearly shows that their distribution will be positive for both the developed and the developing countries, and that it will also be unequal: of an estimated increase in world real income of about \$200 billion (which is about 0.9% of the World GDP) the developing countries will receive about \$179 billion (World Bank, 1995) — and will be the merrier because they suffer much more from protection-induced "distortions" (especially in agriculture) than the developing countries! Further, the size of the income gains from the trade in intellectual property rights (TRIPS) is also large for the developed countries: in the Group of Seven countries the total income from intellectual property rights grew from \$7.1 billion in 1980 to \$30 billion in 1991 (Harmsen, 1995; and these gains will grow bigger after the UR Agreement, even though there is a possibility that greater international investment may also flow to the developing countries from a stricter adherence to this accord. Thus, indeed, if the likely (positive but even more unequal) gains from the TRIPS accord are added to the developed countries' overall gains, some mechanism will have to be found to compensate the losers (the developing countries) — either directly by the gainers (the developed countries) or indirectly by the multilateral financial institutions such as the World Bank, the International Monetary Fund (IMF), etc.

Second, the choice between import substitution and export expansion will not be as open in the post-UR world trading order as in the decades of the 1950s and the 1960s — when to be an infant industry "was very heaven." No longer that; the infant-industry protection, though still available under Article 18-c of the GATT, will be much more difficult to practice as tariff and nontariff barriers everywhere are reduced sharply. In addition, the UR Agreement does not look favorably at the various clauses of the GATT — i.e.,

Article 18, Part IV and the Enabling Clause — that have justified so far (at least on paper, if not in fact) a "special-and-differential" (S&D) treatment of the developing countries. This suggests that import restrictions — a principal instrument of industrial growth since the Industrial Revolution among the "pioneers" and the "late-comers" — will no longer be permissible in many cases to protect domestic industries in the developing countries. But would it enable them to reap the promised growth rewards attributed to greater export expansion? Perhaps; but not certainly, because their access to developed countries' markets is not likely to improve dramatically. This is because even as the nontariff barriers on textiles and clothing are lowered by the developed countries under the terms of the UR Agreement, the new "bound" tariff rates are, in some cases, higher than the current rates. In addition, the protection levels in agriculture remain higher than in the pre-UR period in many cases, and generally high in most cases, a fact which has significantly reduced the expected production and welfare gains from the UR Agreement (Ingco, 1995); and the UR Agreement does not exclude the use of anti-dumping (AD) duties by the developed countries to shut out the lower priced exports from developing countries on grounds of "predatory" pricing. Indeed, an even greater use of AD laws, safeguard clauses, and countervailing duties against developing countries' exports remains a distinct possibility (Low and Yeats, 1994; Finger, 1994).

Third, the fact that developing countries will be less able to invoke the "nonreciprocity" principle, enshrined in Article 18 of the GATT, as they "graduate" (actually or on paper) also means that the reciprocity principle will increasingly govern the post-UR world, even though not always in a nondiscriminatory fashion — because the Safeguard Clause (Article 19 of the GATT) has now been altered in ways that make discrimination between competing developing country suppliers possible. Among other things, this means that the developed and developing nations will not be guided by the free trade principle as envisaged by neo-classical (and classical) economics — for the simple reason that the reciprocity principle, though a powerful instrument to secure the mutuality of tariff concessions between the contracting parties, is essentially mercantilist in construction: it sees a greater access to developed country markets as an act of sacrifice which must be compensated for by tariff reductions by the developing countries (Bhagwati, 1990).

Finally, the outcome of such negotiations will be decided, as before, by the balance of international economic power, which is more likely to tilt against the developing countries because they will not be left with much bargaining power by the time the UR Agreement comes into full force. There is, of course, the (theoretical) possibility that the gains from the UR Agreement will be bigger for those developing coun-

tries which liberalize their foreign trade the most, even unilaterally (World Bank, 1995); but in the real world, run on the reciprocity principle rather than on the free-trade principle, the developing countries must offer something more tangible than a mere demonstration of a more rational economic management to get a greater market access in the developed countries' markets.

4. MARKET AND GOVERNMENT

It has been asserted that development economics suffers fatally from an innate *etatisme* so that a proof of the superiority of the free markets amounts to disproving its logical validity. But such proofs are generally fallacious because they are mere assertions of an irrepressible ideological and neoliberal bias in favor of markets and against governments. Thus, for instance, the desirability of government intervention is sometimes conceded — e.g., it made the East Asian miracle happen — but only when it works (World Bank, 1993)! Such a bias is, however, hard to explain because *laissez faire* has never happened at any time in economic history.

The debate on the issue has been conducted at four distinct levels, each of which should be noted carefully for clear thinking.

First, there is the all-out advocacy of free and competitive markets, which are assumed to work with textbook accuracy in the real world. Given the fact that the market prices equal the shadow prices both in the product market and the factor market, and that all these markets do exist, prices perform an inexpensive informational role in organizing consumption, production, and distribution efficiently (Bator, 1958). Once this is granted, government intervention can only spoil the utility-profit maximization calculus.

Second, assuming that technological change is exogenous and that investment is fully appropriable, it can be shown that the government can do nothing to promote accumulation and growth. Thus, the equilibrium growth path will also be socially efficient if individuals are farsighted enough to save optimally not only for themselves but also for their offspring (Grossman and Helpman, 1994).

Third, it is argued that even though the market fails in the face of externalities, government intervention does not necessarily follow from this, because the governments also fail — and this failure is generally more costly than market failure (World Bank, 1991). Furthermore, governments do not typically seek to maximize some social welfare function; instead, they respond to lobbying by vested interests. Even worse, they are, as a rule, corrupt (Krueger, 1974; Bhagwati, 1982; Brock and Magee, 1984). According to the rational-expectationists' version, government intervention is both irrelevant and counterproductive because the "real world" economies are self-regulat-

ing and self-equilibrating because economic agents already know what the government says it knows (Lucas, 1972; Lucas and Sargent, 1978).

Finally, it has been argued that market-based solutions should be sought even when the market is not issuing the right signals due to some malfunctioning in the capitalist system. For instance, by satisfying the "perfect market contestability" conditions, private producers may be prevented from excessive profits and predatory and cross-subsidy pricing practices (Baumol and Lee, 1991). Moreover, theoretically, enough markets can be created — e.g., future markets can be established to indicate to the present producers about the future demand for their goods; and contingent markets may repair the market failures caused by informational deficiencies about the true state of the world. If property rights are well defined, the outcome of a game theoretic type of bargaining process — i.e., by moving onto a new contract curve through bilateral trading — will be Pareto-optimal and efficient (Coase, 1960; Buchanan and Stubblebine, 1962). The "local" public goods, which can be consumed only selectively by the residents of a certain area, can be consumed by an individual (to the exclusion of the nonresidents) by moving to that locality (Tiebout, 1956). In addition, public goods can be allocated by creating the market to achieve a competitive equilibrium through the introduction of personal, Lindahl prices — to price the individual demand for public goods — provided that the consumers behave competitively and the "endowments of a society have already been redistributed to achieve an ethical optimum" (Foley, 1970, p. 69).

It should be easy to see, however, that there is not much force in these arguments; and even when they are valid the underlying assumptions are too "other-worldly."

First, attaining to the textbook primordial state (of nature) — blessed by the equality of the marginal rates, of substitution in consumption with the marginal rates of (domestic and foreign) transformation in production — may not be a rewarding experience because market success is guaranteed only if there are enough markets; if both the consumers and the producers behave competitively; and if equilibrium exists. A nonsatisfaction of any of these conditions amounts to a withdrawal of the guarantee of market success (Debreu, 1959). Thus,

a pure market system with its high degree of decentralisation runs the risk of bringing inequitable results and being inefficient because markets can never be complete, externalities exist, and public wants tend to be neglected (Malinvaud, 1989, p. 71).

It also follows that if the (buyers' or producers') monopoly power exists, or if relevant markets do not exist, then market failure is unambiguous, and some kind of government intervention is desirable on welfare grounds (Vickers and Yarrow, 1991).

Second, the many remedies suggested to find a market-based solution of externalities, though possible, may not be feasible. For instance, "free riding" may prevent the individual consumers and producers from acting competitively (Arrow, 1969). When the (unstated) assumption that the players in a cooperative game know every other player's pay-off as a function of the strategies played does not hold, the market process cannot possibly lead to an equitable distribution of property rights (Arrow, 1979). In addition, the markets for future goods simply may not exist, so that the creation of "future-oriented institutions" by the government becomes a central issue — especially in the context of developing countries (Newbery, 1992).

Third, while government may be wasteful when patronizing rent-seeking and DUP activities, the same is the case with modern managerial capitalism (Edlin and Stiglitz, 1992; Galbraith, 1992). Indeed, it is not an uncommon sight when an "agent" in the free market commits "fraud" against the "principal" by misrepresenting the information that he possesses to misguide the latter into doing things he would not have done otherwise. In this case, real resources are diverted to the provision of unnecessary services (Karni, 1989). So, the government may have to intervene to reduce essentially wasteful private rent-seeking (Streeten, 1993)!

Fourth, in cases where a public good characterized by nonexclusivity and indivisibility must be produced, where structural change involving a redistribution of private property rights must be made, or when large amounts of investable resources must be raised to initiate and diversify the development process, and when, as Kuznets (1971) notes, "policy action and institutional changes are required [to minimize] the costs of, and resistance to, the structural shifts implicit in, and required for, a high rate of growth" (p. 130), state intervention in these and similar other situations could be welfare-raising.

Finally, technological change requires the existence of the Schumpeterian monopoly profits, and the investment returns are not fully appropriable because of the existence of "spill-over effects" (Romer, 1990). In both cases, market efficiency is violated. Moreover, if left to the market alone, there may be too much investment in R&D because of the spill-overs, and too little of it in manufacturing (Stokey, 1992).

5. ETHICS AND DEVELOPMENT ECONOMICS

Development economics has long suffered from a deep-rooted tension. On the one hand, its principal concerns are essentially moral and ethical. These are enhancing people's well-being by a fair and equitable distribution of the fruits of economic progress and by minimizing the incidence of poverty, famine, unemployment, etc. For instance, as Singer later com-

mented on his own justly famous 1950 paper, it "concentrated on the issue of distributive justice or fairness or desirability in sharing out the gains from trade" (Singer, 1984, p. 284). In such conceptualizations of development economics, a rapid rise in per capita income assumes an instrumental value; it is the means to achieving economic progress. The end of economic development is sometimes identified, on moral grounds, as putting "people back at centre-stage" (Streeten, 1994). On the same moral grounds, the preferred means would ensure the fastest "human development" by achieving a higher level of literacy, health, and longevity of life (UNDP, 1990). Fundamentally, this line of thinking rejects the position that human motivation can be reduced to the pursuit of a single object: self-interest. On the other hand, since its inception, development economics has often displayed an arid detachment from all the relevant ethical issues — in deference to Robbins's positivism (1932). Lewis's (1954) *sang-froid* was typical and is worth remembering: "We are not interested in the people in general, but only say in the 10 percent of them with the largest income . . . (p. 416).

As a result of this "inner" split, development economics has remained ambivalent when making choices involving value judgements. Its recent drift to market capitalism — which preaches a one-sided quick-march to efficient market solutions — is an example of such ambivalence because the society's ethical values may be undermined by the development of market economies (Hirschman, 1985). Another example of schizophrenic confusion is its somewhat uncritical acceptance of an incompatible philosophy of "structural adjustment," which has nothing structural about it and is implemented in a patently inequitable fashion, e.g., by raising the prices of food and other goods and services normally consumed by the poor, who are the "net losers since full compensation rarely takes place" (Corden, 1987, p. 5). Yet another example is the manifest disregard of equity concerns in the design of tax reforms to maximize tax yields, say, when a value-added tax becomes the principal revenue-raiser while the rates of direct taxes are reduced without broadening the tax base equitably, and when the expenditure on social services is curtailed first to reduce the budgetary deficits (Burgess and Stern, 1993).

True, there are reasons for taking the patently anti-ethical stance on development issues. Like neoclassical economics, as well as Marxian economics, Adam Smith's well-known maxim — namely, "it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interests" (Smith, 1976, pp. 26–27) — has been taken to be a licence, incorrectly, for unregulated self-interest maximization by development economists as well.³ According to this line of thinking, rational behavior is taken as a synonym for self-interest

maximization; and indeed any activity other than maximizing self-interest, such as the pursuit of altruistic objectives, is considered irrational. Stigler (1981) maintains that: "... in situations where self-interest and ethical values ... are in conflict ... the self-interest theory will win" (p. 176). The positivist's claim is strongly supported by the Pareto-optimality principle, which is entirely efficiency-oriented and leaves little room for the kind of normative judgements that are required to fulfill the equity objectives. True, the Pareto-optimality principle, when interpreted as the "core" or a "value" highlighting its stipulation about the perfect redistribution of property rights, does involve some kind of normative judgement (Khan, 1991); but the further stipulation that such a redistribution be secured through lump-sum transfers (not actually carried out but only potentially visualized in the true neoclassical tradition) undoes any pretension of the principle as to encompassing socially meaningful normative judgements. True, the Pareto rule reflects unanimity, *à la* Buchanan and Tullock (1962); but such unanimous value judgements are not secured by presenting the "voters" with real-life redistributive schemes of the existing (unjust though legal) property rights. Moreover, the existence of a state marked by unanimity may not be the one permeated by happiness because it may simply reflect defeatist compromises with the harsh reality induced by hopelessness (Sen, 1984).

A related line of thinking is that of Nozickian non-consequentialism, which advocates the priority of specific processes over results. According to Nozick (1974), any attempt to "pattern" the existing distribution of income and wealth may be regarded as an infringement of individual rights. Thus, the goodness of a society is evaluated by reference to the (legal) correctness of the procedures rather than by judging the consequences of the exercise of their ("moral") rights by individuals, including private property rights, their exchanging such rights freely or donating them, or bequeathing them to the posterity.

One remedy to cure the theoretical and practical inconsistencies of the excessive preoccupation of development economics (indeed, of mainstream economics as well) with positivism is to moderate its overwhelming reliance on the Pareto-optimality principle (Naqvi, 1993). More relevant to development economics are the decision rules that take a broader view of human motivation and encompass moral considerations in addition to the self-interest maximization principle, on which rest the claims of modern neoclassical economics. For instance, there is Harsanyi's (1977) "equiprobability model for moral value judgements," which explicitly recognizes that a typical individual possesses not only personal preferences but also moral preferences which "guide his thinking in those — possibly very rare — moments when he faces a special impersonal and impartial attitude, that is a

moral attitude" (p. 635). Hare (1963) emphasizes that the individual's rational behavior should not differ when acting in "similar circumstances." Even more relevant to development economics is the nonutilitarian Rawlsian approach — especially the Difference Principle — which focuses on the advantage of the least-privileged in the society. Such an advantage is measured in terms of "primary goods," things that every rational human being wants — rights, liberties, and opportunities, income and wealth, and social bases of self-respect (Rawls, 1971). In this view, individual liberty is essentially a "luxury good" in each individual's preference function (Mueller, 1979). An attractive feature of the Rawlsian principle for development economics is that it is consistent with the prevalent notions of justice in developing countries which require making suitable changes, *à la* Marx, in the existing social order, if it is not consistent with such notions.⁴

The ethically determined ends of economic development are essentially reference points to position the (positivist) economic remedies efficiently. Indeed, "the simple picture of the economist who provides value-free technical information to the decision-maker is at best a useful caricature" (Hausman and McPherson, 1993, p. 672). Thus, for instance, the immoral feudal structures that dominate the economic landscape in most developing countries cannot be justified just because in a certain view of moral rights these have "arrived" today by using correct legal procedures. Moreover, insofar as extreme poverty, hunger, and even famines result from the exercise of legally sanctioned rights rather than natural calamities (Sen, 1981), the attempts to remedy such obvious social injustices cannot be held as an infringement of individual freedom. Thus, development policy must aim to provide food and other primary goods needed by the least-privileged in the society; and issues such as the distribution of income and wealth should be relevant for development economics — even though the "equality of result implies a distribution process that is the antithesis of the market" (Coleman, 1989, p. 52).

6. CONCLUDING REMARKS

It should be clear now that the vision of development economics about the broad purpose and strategy of economic development is essentially correct. The many contrary assertions surveyed in this paper do not diminish the subject's (exclusive) claim to understanding the economic (and social) reality in the developing countries better than can be done with the help of, say, the neoclassical economics of Walrasian vintage — where, given the "right" prices, all markets clear so that no (involuntary) unemployment is possible; in which the problems of distributive justice (of the Paretian type) are assumed to have been solved by

making lump-sum, non-distortionary transfers (Hicks, 1965); or in which all externalities are self-correcting if the externality rights can be exchanged in a competitive market at zero transaction costs (Coase, 1960).

My argument can be summarized briefly.

First, the recent elaborations of the neoclassical growth theory are not a substitute for development economics even in explaining what causes per capita income to grow over time, for the simple reason that they say nothing about the growth-promoting process of structural transformation. As such, they cannot offer much useful policy advice beyond what is common knowledge: invest enough in human capital and R&D. But, of course, this is not to deny that these elaborations do reinforce the basic insights of development economics — external economies, complementarities, increasing returns, technological progress, etc. — within a formal mathematical framework.

Second, in the perennial debate about the relative roles of the government and the market, there is no warrant to privatize everything — including common sense — in the vain search for efficient market solutions, because “it is not true that economic theory ‘proves’ that free markets are always [the] best” (Krugman, 1992); because precipitate privatization is normally a very costly process⁵; and also because even when the market does succeed (i.e., is efficient), there is no guarantee that the outcome will be socially desirable — e.g., when in the event of a famine, the food goes to those with purchasing power, while those without it starve!⁶ The latter-day denial of the state not doing any good to the society, so that the less we have of it the better, is essentially wrong-headed because there is a large area of social life where state intervention is obligatory; it is also dangerous, because a state not doing development work is not the one that would help economic progress through the market either. True, the traditional sentimental view of the state as always acting as a conscience of the society will also have to be modified to recognize that the state, to some extent, reflects the interests of various lobbies and pressure groups (Becker, 1983); but this fact actually warrants government intervention to regulate the illegal pressurizing of public officials by private lobbies. In general, the assertion that the government can do no better than the market is simply false because efficient market allocation can be helped by sensible government intervention (Greenwold and Stiglitz, 1986). There is ample room for the public sector and the private sector to coexist — within the mixed-economy framework of a society like ours — to seek remedies for such fundamental problems as slow growth, unemployment, poverty, illiteracy, inadequate supply of health services, etc. It is more reasonable to expect that both when the government and the market fail and when they succeed in specific situations, remedial policy action which maximizes social welfare may be

required. It would, in general, be market-based or interventionist (requiring some degree of development planning), depending on the magnitude of the information costs involved in coordinating investment decisions — an attitude which is closer to the teachings of development economics than of neoclassical economics. To this end, we should focus on “a mutually supportive structure of market and non-market institutions that best suits the requirements of economic development” (Datta-Chaudhry, 1990, p. 38).

Third, in relating trade to growth, both the mercantilist protectionism and Smithian free-trade idealism may have become inappropriate reference points in the post-UR world trading order. In it, the success of the developing countries to export more will not come through by deceptively simple tricks like “letting the prices come right,”⁷ as if out of state inaction. It would rather depend on the government’s improving its ability to innovate (to some extent, by import-substituting “knowledge” rather than “goods”) and to improve the quality of exports.

This will require making greater investment in R&D and taking advantage of the knowledge “spillovers” — which is the main message of the endogenous growth theory; it will also take accelerating the process of structural transformation to diversify the export structure — as advised by development economics. The moral of the story is that the post-UR world would probably be beneficial eventually to the developing countries, but the weak chain of causation between trade liberalization, exports, and growth must be made stronger, not by simply specializing more in the traditional (unskilled) labor-intensive industry, but by applying new scientific ideas to the production processes; and by taking full advantage of the universal phenomenon of “product fragmentation” (Jones, 1993).

The concern of development economics for a fairer distribution of the gains from trade and investment remains a valid issue in the post-UR era. In this context, both the import substitution and the export expansion strategies remain relevant, even though the scope for the former has been significantly reduced by the UR Agreement. The secret of success, as in the case of the East Asian countries, is to make a speedy and efficient transition from one strategy to another in response to the changing conditions of the world demand, and to expand the tradeable sector by making it science-based rather than resource-based.

Fourth, the ethically determined rules of economic behavior are required to issue adequate instructions to distribute the fruits of economic progress equitably, and also to be concerned about such problems as poverty, illiteracy, ill-health, and high rates of (open) unemployment (Klein, 1978, 1985; Malinvaud, 1989b) — all issues which carry a clear altruistic ethical motivation and which do not admit of a simplistic market-clearing prescription. The argument that the

market-given freedom economizes on the use of scarce ethical resources (Arrow, 1972) is true to some extent; but the fact remains that altruism is not a scarce resource; rather, it increases (decreases) with a more (less) frequent use (Hirschman, 1985, p. 362).

Thus, it would not be a correct perspective to view development economics as essentially positivist, hell-bent on finding efficient solutions even if unjust. Our discipline is normative and prescriptive by temperament: it describes not only what the state of underdevelopment is, but also prescribes, in a "consequentialist" vein, what ought to be done to modify this state by suitable policy action. When thinking about development issues, it should be neither irrational to act

morally nor immoral to act rationally — especially because the inculcation of moral and ethical values is growth-promoting, and doing so reduces the cost of policing and contracting in society (Reder, 1979). By the same token, a greater ethicalism makes it easier to undertake a major restructuring of the unjust social and economic institutions, both national and international — to make them just and to make economic development both possible and meaningful for the large majority of humankind who sullenly endure what they cannot change. The job of combining efficiency with justice and realism with compassion for the poor, the needy, and the downtrodden is difficult; but it must be done to change the world for the better.

NOTES

1. Little (1994, p. 378) denies that the East Asian experience is a "miracle" because "the rapid growth of a number of East Asian countries is fully explicable in conventional economic terms, that is, [a] *[sic]* very high rate of both material and human investment . . .".
2. As if to establish its somewhat exaggerated claim to originality in the realm of ideas, the endogenous growth theory hardly ever mentions the contributions of development economics even when emphasizing the importance of such staples of our discipline as external economies, increasing returns, complementarities, and technological change!
3. That Adam Smith, who was a Professor of Moral Philosophy, did not mean that such licence may be inferred from his view that "to the interest of [the] community, he [the individual] ought at all times to be willing that his own little interest should be sacrificed" (Smith, 1790, p. 140).
4. It should be noted, however, that in principle the Rawlsian maxim, which focuses on maximizing the welfare of the worst-off in the society, must be amended to yield dis-

tributive justice. This can be done by linking the degree of inequality in different states of the economy to the position of the worst-off individual(s) in those states with respect to inequality, and by stipulating that for one state of the economy to be worse than the other, the welfare of the worst-off individual(s) must be in a worse condition within that state (Temkin, 1986).

5. Sinha (1995) reports that such costs in the British case (which is considered to be the most efficient) reduced the net earning from the sale of public enterprises to only 39% of the gross returns; and that most of this reduced earning was not spent on industrial and infrastructure regeneration (p. 561).
6. Paul Streeten's letter dated May 21, 1995, addressed to the present author.
7. A distinction should be made between (the legitimate policy of) "setting the prices right" and (the not-so-legitimate non-policy of) "letting the prices come right." See Lipton (1991), cited by Streeten (1993).

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