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Advancing Development

Core Themes in Global Economics

Edited by

George Mavrotas and Anthony Shorrocks

Studies in Development Economics and Policy

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Preface

George Mavrotas and Anthony Shorrocks

The 20 years since the World Institute for Development Economics Research (UNU-WIDER) began work in 1985 have witnessed major changes in the world economy that have profound implications not only for the developing world but also for development economics itself. In June 2005, leading researchers and policy-makers met in Helsinki on the occasion of WIDER's jubilee anniversary, to reflect upon current thinking in development economics and on what the next two decades might hold. The conference sought to highlight new and emerging issues in development, to consider how research can best address these issues and to identify promising methodologies that could advance the frontiers of research and practice. The two-day conference (17–18 June 2005) covered a broad range of development topics including growth, trade and finance; poverty and inequality; strategies for poverty reduction; conflict; and economic policy making. In addition to current research issues, the presentations focused on the challenges and dilemmas which are likely to engage researchers and policy-makers over the next 20 years. The present volume entitled *Advancing Development: Core Themes in Global Economics* contains a selection of papers from the jubilee conference and is dedicated to the memory of Lal Jayawardena, the first director of UNU-WIDER.

The world as we know it is one in which there is a great deal of deprivation, disparity and strife. Globalization may have shrunk distances among countries, but it has not succeeded in bridging the yawning gap between the rich and the poor of this world. One consequence is a growing imbalance in trade and power relations. The ability of poorer countries to cope with and benefit from globalization has been impeded by dwindling international aid flows, volatile private capital movements, a lack of attention to human security and the causes of conflict, as well as the social costs of market liberalization. The deep poverty that is still widespread – especially in Africa – is a stark reminder that all is not well with the world, even if some parts of it have experienced regular improvement in their level of prosperity. Pessimism, resignation, indifference, or recourse to looking the other way, are all possible responses to the state of the global order. But engagement is also on the menu, and it is this option that WIDER, in furtherance of its mandate, has pursued. By drawing on the expertise and commitment of a broad international body of researchers, WIDER has endeavoured to come to grips with the reality of the world's problems, to understand the nature of the processes at work, to describe and evaluate the vicissitudes of global development, to provide sound empirical and conceptual bases for policy analysis and to hold out hope for solutions to problems which might otherwise be regarded as intractable. In the process, WIDER has presided over a body of research which can claim in parts to be genuinely seminal, policy-rich and path-breaking.*

* See T. Addison, A. Shorrocks and A. Swallow (eds) (2005), *Development Agendas and Insights: 20 Years of UNU-WIDER Research* (Geneva: UN Publications), for a discussion of WIDER's history and research activities.

The present volume seeks to continue this tradition. As suggested by the title, one aim is to document the way that development economics has advanced, by reviewing the evolution of past thought on the subject and anticipating possible future directions. 'Advancing Development' is also an appropriate description of the role that WIDER has set itself as an institution dedicated to the promotion of policies for improving the lot of those living in the developing world. The volume may therefore be viewed as a reflection of WIDER's interests and a celebration of WIDER's achievements during its first two decades of existence. Finally, 'Advancing Development' is a fitting epitaph for Lal Jayawardena, whose energy and vision laid the foundation for WIDER's success, and whose considerable personal contributions to development thinking continue to inspire the work of the Institute.

The volume consists of eight parts, each of which deals with a core area of development economics. The authors of the 36 chapters have striven to address key issues in a non-technical manner in order that the volume is accessible to readers who are not accustomed to the technical language of academic journals. However, rigorous analysis and in-depth discussion of the issues have not been compromised. A few of the chapters provide comprehensive and critical reviews of the relevant topic. But most of the contributions are not intended to be surveys, aiming instead to present thoughtful views on important and timely issues in development economics.

Part I, entitled *Development Economics in Retrospect*, offers a fascinating tour of the history of thought on development economics, illuminating its evolution into a significant and dynamic area within economics. In this regard, **Erik Thorbecke** classifies the body of knowledge into four interrelated components: the prevailing development objectives; the conceptual state of the art relating to development theories, models, techniques and applications; the underlying data system; and the resulting development strategy. The main contributions and changes to these four components are traced, decade by decade, starting from the 1950s. **Louis Emmerij** asks a number of questions regarding development thinking and practice, such as why and when turning points occur; what options are available when it comes to economic and social development policies; and what is the notion of culture in development. He also compares the merits and disadvantages of global development theories with regional and local development policies that place more emphasis on the role of culture in economic development. **E. Wayne Nafziger** compares alternative conceptions of the meaning of development over the past 30 years, with special reference to the work of Dudley Seers and Amartya Sen. Nafziger argues that both thinkers were critical of the development literature of their times, and that one of the challenges for future work is for development economists to be more holistic, integrating economic development, human rights and conflict reduction. In his contribution, **Richard Jolly** claims that global inequality (the gap between the rich and the poor) has grown substantially by almost every measure since it was identified as an issue in the influential works of Adam Smith, Tom Paine, John Stuart Mill and Karl Marx. Over the last two or three decades, national income inequality has also grown. Jolly recommends more attention be given to the extremes of inequality, especially the sources of extreme wealth and poverty, and how these sources are linked to injustices in the past.

The historical perspective on inequality provided by Jolly leads conveniently to the theme of *Inequality and Conflict* covered by four chapters in Part II. A concern with inequality is central to development strategies. At the same time, the nature of conflict has undergone profound change in recent years and violent conflict can further aggravate inequality problems in the developing world. **Giovanni Andrea Cornia** and **Leonardo Menchini** juxtapose changes over the last 40 years in income growth and distribution with the mortality changes recorded at the aggregate level in about 170 countries and at the individual level in 26 countries. They highlight the similarities and linkages between changes in income inequality and health inequality, and offer some tentative explanations of the trends. The chapter by **Eric M. Uslaner** argues that economic inequality provides a fertile breeding ground for corruption which in turn leads to further inequalities. Uslaner uses Romanian data to estimate a simultaneous equation model of trust, corruption, perceptions of inequality, confidence in government and demands for redistribution, and shows that perceptions of rising inequality and corruption lead to lower levels of trust and demands for redistribution. The following chapter by **S. Mansoob Murshed** discusses the problems of achieving lasting peace. One important aspect is an equitable division of the post-war economic and political settlement (the 'peace dividend'). Murshed also discusses how perceived injustices can lead to a deep sense of humiliation, an important factor in acts of transnational terrorism and one not easily deterred by force alone. **Marcia Byrom Hartwell** examines the reasons for the escalation of violence following peace agreements in early post-conflict transitions and the implications for development. She describes the underlying dynamics, including the relationship between perceptions of justice as fairness, the formation of post-conflict identity, the political processes of forgiveness and revenge and the policy implications for development.

Issues related to *Human Development and Wellbeing* (Part III) have been for many years at the heart of the research and policy agenda in development economics, and have more recently received considerable attention in connection with the Millennium Development Goals (MDGs). **Farhad Noorbakhsh** examines differences in the human development index across countries, and finds some evidence that these differences narrowed over the period 1975–2002. While country positions remained relatively stable during the early part of the period, this was followed by considerable upward and downward movement, indicating a possible example of the 'twin peaks' type of polarization. In recognition of the importance of health, both as a source of human welfare and as a determinant of overall economic growth, **Nora Lustig** examines the impact of the Popular Health Insurance programme in Mexico, which was first introduced as a pilot programme in 2001, and became part of the formal legislation in 2003. Lustig reviews some of the early results of the programme, along with the improvements made so far to public health coverage in Mexico. **David Fielding**, **Mark McGillivray** and **Sebastian Torres** discuss the findings of research into the impact of foreign aid on human development. Instead of looking at per capita income, as is common, they look at how aid affects a range of human development indicators, including health, education and fertility, and allow for the fact that these different dimensions of wellbeing are likely to interact with each other. **Stephen Knowles** points out that the literatures on social capital and on institutions rarely acknowledge the existence of each other. He believes that cross-country evidence on both subjects could be enriched by empirically modelling social capital as a fundamental determinant of development.

During the last two decades the world economy has experienced an intense evolution of economic policy, particularly in the area of international trade. At the same time economic integration has increased, as reflected in higher trade and financial flows. This process – *Globalization* – has also affected the movement of people and knowledge across international borders. These issues are the subject of Part IV, along with the cultural, political and environmental dimensions of globalization that go beyond international trade. **Nancy Birdsall** argues that openness is not necessarily good for the poor. Reducing trade protection has not brought growth to today's poorest countries, and open capital markets have not been good for the poorest households in emerging market economies. Birdsall presents evidence on these issues and also discusses the asymmetries that help explain why countries and people cannot always compete on equal terms on the 'level playing field' of the global economy. **Machiko Nissanke** and **Erik Thorbecke** stress that globalization offers participating countries new opportunities for accelerating growth and development but, at the same time, also poses challenges to, and imposes constraints on, policy-makers in the management of national, regional and global economic systems. They discuss the various relationships embedded in the openness-growth-inequality-poverty nexus and analyse how globalization affects poverty, concluding with some thoughts on formulating a set of measures to make globalization more pro-poor. **Arjan de Haan** explores the role that migration has played in development studies and in debates on economic growth and poverty. Highlighting the importance of interdisciplinarity and of an institutional understanding of the processes of economic growth, he argues that development economics needs to draw more strongly on the insights and approaches of social scientists outside economics.

Despite the rapid and large increase in flows of trade, finance and technology across the global economy, most developing countries have limited access to the finance deemed necessary for development; and lack of finance limits the ability of many countries to diversify their trade, to access new technologies and to reduce poverty. *Development Finance* issues are the subject of Part V in this volume. **Valpy FitzGerald** examines the linkages between international risk tolerance, capital market failure and capital flows to emerging markets. The microeconomic roots of home bias and demand instability are explained in terms of investor risk perception and credit rationing, exacerbated by the behaviour of traders. FitzGerald concludes by examining the implications of his findings for the future of development economics in general and for policy response in particular. **Silvia Marchesi** and **Laura Sabani** review the literature dealing with the failure of conditional lending and propose a novel explanation: the repeated nature of IMF involvement, together with the fact that the IMF acts simultaneously as a lender and as a monitor (and as an advisor) of economic reforms, weakens the credibility of the IMF threat. They conclude that prolonged use of IMF resources is not only a consequence of the ineffectiveness of conditional lending but may itself be a determinant of conditionality failure. **Tony Addison** identifies five broad topics in international finance that may become prominent over the next 20 years: the flow of capital from ageing societies to the more youthful economies of the South; the growth of the financial services industry in emerging economies and the consequences for their capital flows; the current strength in emerging market debt; the impact of globalization in goods markets in lowering inflation expectations; and the implications of the adjustment in global imbalances between Asia (in particular China) and the United States for emerging bond markets as a whole.

The chapters included in Part VI, *Growth and Poverty*, cover various aspects of the growth process in developing countries and the formulation of pro-poor policies. **Mark Blackden**, **Sudharshan Canagarajah**, **Stephan Klasen** and **David Lawson** examine the issues related to gender and growth in sub-Saharan Africa. By identifying some of the key factors that determine the ways in which men and women contribute to, and benefit (or lose) from, growth in Africa, they argue that looking at such issues through a gender lens is an essential step in identifying how policy can be shaped in a way that is explicitly gender-inclusive and beneficial to growth and to the poor. Focusing on cross-country differences in output per worker between 1980 and 2000, **Pertti Haaparanta** and **Heli Virta** decompose changes in the distribution of labour productivity into changes in productive efficiency, changes in best practice technology, accumulation of physical capital and accumulation of human capital. The study focuses on low-income countries, and especially on highly indebted poor countries (HIPCs), which could not be done in earlier studies. **Nanak Kakwani** and **Hyun H. Son** discuss how the targeting efficiency of government programmes may be better assessed. Using their own 'pro-poor policy' index, they investigate the pro-poorness of not only government programmes aimed at the poorest segment of the population, but also basic service delivery in education, health and infrastructure. **Lakhwinder Singh** focuses on the long-term innovation strategy of industrial and technological progress in developing countries. Growth theory, empirical evidence and several indicators of innovation are used to draw lessons from the historical experience of the developed and newly industrializing countries for the industrial development of the poorest economies. **Sukti Dasgupta** and **Ajit Singh** use a Kaldorian framework to examine the evidence of deindustrialization in developing countries at low levels of income, the jobless growth in these economies and the fast expansion of the informal sector. These questions are specifically examined for the Indian economy using state-level data, but the analysis can be applied more broadly to economic policy in developing countries.

Part VII focuses on the core theme of *Development Strategies* in the developing world. **Guillermo Rozenwurcel** explains why all development strategies have failed in Latin America, arguing that after the Great Depression and throughout the rest of the twentieth century, Latin American countries followed two successive and contradictory strategies, namely import substitution industrialization and the Washington Consensus approach. However, neither managed to deliver sustained economic development due to the failure of the state and the inability to achieve mature integration into the world economy. **Álvaro García Hurtado** draws more positive conclusions from the experience of Chile over the period 1990–2005. García Hurtado argues that Chile has shown remarkable results in terms of growth, poverty reduction and democratic governance. He stresses that Chile did better in terms of growth than social integration, and that this is related to the weak representation and participation of a large portion of the population in the national debate and decision-making process. **Annelies Zoomers** extends the geographical coverage by examining successes and failures in three decades of rural development projects in Africa, Asia and Latin America, using the evidence to suggest how development interventions can be made more effective. **Justin Yifu Lin**, **Mingxing Liu**, **Shiyuan Pan** and **Pengfei Zhang** examine the linkages between development strategy, viability and economic institutions in China, arguing that the distorted institutional structure in many developing countries after the Second World War can be largely explained by government adoption of inappropriate development strategies. They also examine the evolution of economic institutions and government development strategies in China from the 1950s–1980s. **Grzegorz W. Kolodko** explores the crucial nexus between institutions, policies and economic development. According to Kolodko, progress in market-economy institution building is not itself sufficient to ensure sustained growth: another indispensable component is an appropriately designed and implemented economic policy which must not confuse the means with the aims. **Richard M. Auty** identifies two basic trajectories to a high-income democracy linked to the scale and deployment of rents in developing countries. Low-rent countries tend to generate developmental political states that competitively diversify the economy and sustain rapid per capita GDP growth. This strengthens three key sanctions against anti-social governance: political accountability, social capital and the rule of law. In contrast, rent-rich countries are likely to experience a slower and more erratic transition. In his chapter on the role of credit co-operatives in locally financed economic development, **Robert J. McIntyre** stresses transitional and developing countries often fail to produce institutions capable of supporting economic development with localized saving-investment cycles. The advantages of credit co-operatives in mobilizing and financing local economic development are contrasted with the disadvantages of both conventional microcredit and the most recent neoliberal fashion of so-called 'new wave financial institutions'.

The chapters in the concluding part, *Development Economics in Prospect*, expand and enrich the preceding discussion by looking forward to the crucial issues and policy dilemmas which are likely to preoccupy policy-makers and scholars over the next two decades. **Deepak Nayyar** examines the prospects for development in a changed international context, where globalization has diminished the policy space so essential for countries that are latecomers to development. Nayyar emphasises the importance of initial conditions, the significance of institutions, the relevance of politics in economics and the critical role of good governance. Even if difficult, there is a clear need to create more policy space for national development. Building on Karl Polanyi's work on 'The Great Transformation', **Frances Stewart** considers whether, in the light of the consequences of the unregulated market, a new 'Great Transformation' is needed in contemporary developing countries. Stewart also examines whether such a transformation is likely, reviewing moves towards increased regulation of the market, and also the constraints faced by any contemporary great transformation arising from globalization and the nature of politics. **François Bourguignon** and **Mark Sundberg** focus on the issue of building absorptive capacity to meet the Millennium Development Goals, addressing absorptive capacity in low-income countries from both a theoretical and empirical perspective. They also present a framework (with an application to the case of Ethiopia) for undertaking country-specific analysis, which relates the macroeconomic environment and economic growth on the one hand, and sector-specific micro-constraints affecting implementation of the social MDGs on the other. Discussing the pros and cons of applying behavioural economics to international development policy, **C. Leigh Anderson** and **Kostas Stamoulis** note that many development policies are premised on a traditional economic model of rationality to predict how individuals will respond to changes in incentives. Despite the focus on poverty reduction, economists and others in the development community are still unable to fully understand how the poor make decisions, especially under uncertainty and over time. Behavioural economics may provide more helpful answers. **Mihály Simai** examines critical trends and new challenges affecting the human dimensions of global development. Simai argues that the new state and non-state actors make the system of interests and values more diverse, and that all of these have a major influence on the future of the development process. Developing societies do not need old textbook models, neoliberal, or other utopias as there is a widespread demand for a new scientific thinking on development, with realistic and humanistic alternatives helping collaborative national and global actions. In the final chapter in the volume, **Lance Taylor** reviews the recent growth experience in developing countries with an emphasis on structural change and the sources of effective demand. The means by which policy influences such outcomes is also analyzed in light of historical experience, alongside the options for macro and industrial/commercial policy, and how they influence the growth process. Taylor argues that the recent 'institutional turn' in development theory may obscure serious policy analysis.

The process of preparing this volume has been particularly challenging and rewarding. We are grateful to all of the authors for their enthusiastic commitment to the overall project, and to the referees of individual chapters for their helpful comments and suggestions. Special thanks are due to Lorraine Telfer-Taivainen, who shouldered most of the administrative work for the jubilee conference and was responsible for assembling the complete manuscript. Thanks are also due to Adam Swallow for his advice on editorial issues and to Amanda Hamilton, Economics Publisher at Palgrave Macmillan, for enthusiastically embracing the project from its inception. Finally, we express our gratitude to the governments and other donors who have generously supported the activities of WIDER over the past 20 years; this book and the other outputs and achievements of WIDER would not have been possible without their support and financial backing.

Foreword

Amartya Sen

As the World Institute for Development Economics Research reaches adulthood – it was established 21 years ago in 1985 – there are good reasons to celebrate what has been achieved in what must be seen as rather a short time. The impressively broad range of issues in global economics that are covered in this conference volume, edited by George Mavrotas and Anthony Shorrocks, bring out not only the diversity of problems that are all quite important for development in the contemporary world, but also the fact, in which there is reason to take some pride, that WIDER, as a new institute of research, has been able to contribute substantially to such a variety of fields, informed by a good understanding of the need for coverage as well as quality.*

It is a great pity that the founding director of WIDER, Lal Jayawardena, who set the institute firmly on course and jump-started it from nothing, is no longer with us. The fact that this book is being dedicated to Lal's memory is a small indication of the recognition of what he did for WIDER. Ajit Singh's excellent essay on Lal Jayawardena's remarkable qualities, gifts and accomplishments will give the reader a flavour of the kind of intellectual background and commitment that he brought to WIDER. The reaching of maturity is not, however, only an occasion for celebration and champagne, but also for reflection on the history of this institution, especially since the people originally involved with WIDER are not any less afflicted by mortality than normal human beings are at their respective ages.

The time may not have come yet for an official history of WIDER (but that time cannot be far off), but the ideas, aspirations and commitments of those early years are worth putting on record. In this Lal Jayawardena's leadership was, of course, pivotal, but it was strongly backed by the exceptional cluster of creative and innovative people who made research at WIDER proceed with the speed and understanding that a new research institution badly needs but often does not get. I personally felt immensely privileged to be able to work with such original, communicative and friendly people. Collaborative relations with Finnish and other Scandinavian research and teaching institutions were gradually developed, benefiting WIDER from the presence of rich intellectual traditions in Helsinki and elsewhere. Finnish presence was strong, not only in research collaboration but also in overcoming institutional difficulties in developing an organizational system that could sustain the ambitious research programmes that were planned and gradually implemented.

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* In writing this Foreword, I have been greatly helped by the counsel – and shared memory – of Lorraine Telfer-Taivainen, who runs the Office of the Director of WIDER and who has had an active presence at this institution right from its early days which I talk about in this introductory essay.

The nature of the interactions is, for me personally, well illustrated by the extensive benefit that my part of the research programme, connected with poverty, hunger, nutrition, and quality of life, received from the extraordinary intellectuals who came to the new WIDER. I think of those who joined me to lead these projects, in addition to doing their own research, including Jean Drèze, Siddiqur Osmani, and Martha Nussbaum, but also the remarkable researchers who made it possible for WIDER to do so much so quickly, including Peter Svedberg, Nanak Kakwani, V.K. Ramachandran, and others. I also think of Frédérique Appfel Marglin and Stephen Marglin, who co-directed a different project at WIDER but worked jointly with us often enough. I also recollect with much joy – and appreciation – the contributions that came to WIDER from collaboration with Martti Ahtisaari, Erik Allardt, Sudhir Anand, Michael Bruno, Partha Dasgupta, Robert Dorfman, Robert Erickson, Roderick Flood, Robert Fogel, John Harsanyi, Eric Hobsbawm, Seppo Honkapojha, Janos Kornai, Pentti Kouri, Val Moghadam, Jeffrey Sachs, Thomas Schelling, Ajit Singh, Rehman Sobhan, Gareth Steadman-Jones, Frances Stewart, Marja Liisa Swantz, Lance Taylor, Bernard Williams, Stefano Zamagni, among many others. There was a general sense of confidence that research at WIDER could make a difference to the world, and it was thrilling to see how determined the early workers at WIDER were to make a substantial change in the world of developmental thinking.

Since I had a hand in choosing the name (World Institute for Development Economics Research) that led us to that energizing acronym, WIDER, it was very pleasing for me to see that in its research work, the new institute was indeed taking a very broad view of development – including developmental economics – and was living up to the counsel of that acronymal admonishment. I must, however, acknowledge that in those early days not only was I privileged to observe closely the exceptional work that was going on in the new WIDER, I also had the opportunity of witnessing some of the difficulties that WIDER went through as it got started in Helsinki. The initial problems were particularly manifest in the sometimes troubled public relations through which WIDER went.

During 1983–84, before WIDER got started, Finland's offer to host the soon-to-be-set-up new institute was one of the two proposals that the United Nations University (UNU) was considering when the choice of location and collaboration was finalized. The other 'final round' proposal was from the Netherlands, complete with a plan to base the new organization in Maastricht (some other proposals had been turned down by UNU by then).

The UNU dispatched Alex Kwapong (a distinguished classicist who was Vice-Rector of UNU and a former Vice-Chancellor of the University of Ghana) and me, along with a sizeable team of UNU experts, to both the Netherlands and Finland to talk, assess and advise. It was not altogether an easy decision. The pro-Netherlands school pointed to the well-established fact that it was a country with tremendous experience of international institutions, and also quite importantly, it had a very broad and cosmopolitan media. Those of us who wanted to take up the Finnish offer, despite our admiration for the Netherlands and its experience in international collaboration and communication, saw in Finland a remarkable country of rapidly growing importance, with a deep commitment to global development – and also a country that was, we felt, already firmly on the way to becoming a major player in international thinking. Our arguments for going to Finland did ultimately prevail, and Helsinki welcomed the new WIDER in 1985.

As I think about how WIDER's founding years went, the arguments on both sides, about the comparative merits of different locations, proved to be substantially correct. WIDER's public relations had several problems, but they were made much more arduous by the fact that Finland was then a country effectively of one principal newspaper – with immense influence – and if its reporter took a dislike to something in the new institution it would be extremely hard to generate any different public perception, especially when the news coverage about WIDER got thoroughly linked up with Finland's electoral politics. For quite a few years, the appreciation of WIDER in the international world was immensely higher than its standing in Finland itself. Yet, ultimately, WIDER's work did receive the recognition even within Finland that it was receiving, right from the beginning, across the world. And Finland's deep commitment to global development, which influenced the Finns, from the President of the country to ordinary citizens, did eventually come through loud and clear, and provided the supportive environment in which WIDER's work could flourish and broaden even further.

The early intellectual departures, led by Lal Jayawardena, in the research undertaken in WIDER have been further enriched by the new challenges that Jayawardena's successors have perceptively identified as problems of growing importance. I think particularly of the second director Mihaly Simai's insightful diagnosis that globalization as a problem as well as an opportunity would speedily become a major focus of attention in the contemporary world – a theme that would be further pursued by the next director, Giovanni Andrea Cornia, who also initiated major studies on interregional and intertemporal disparities in living conditions, including morbidity, mortality and life expectancy. WIDER's research work has been further strengthened by the present director Anthony Shorrocks' far-reaching understanding that the centrality of inequality as a contentious issue cannot but influence development work in every field in the world. This has, of course, been helped by the fact that Shorrocks is himself one of the leading experts in the world on the economics of inequality. I have viewed these later initiatives, and others, at WIDER with interest and admiration from a distance, but I had myself, by then, moved on to other commitments. It is, however, extremely satisfying to see that the tradition of breaking fresh ground, which has characterized WIDER's research from the beginning, is continuing to flourish so well, through the leadership of Lal Jayawardena's impressive successors.

The history of WIDER will certainly be written before long in some detail to make the story of that remarkable intellectual initiative more fully understood and assessed. I have pointed to some issues that will, I hope, receive fuller attention then. But having done my little piece here, I can now move on to the champagne moment of celebration and commemoration. So I end by applauding the memory of the remarkable Lal Jayawardena, the achievements of the wide-ranging study for which this foreword is being written, and the continuing rich tradition of 'research for action' that has inspired WIDER from its very beginning. There is indeed something to celebrate here.

Acknowledgements

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List of Abbreviations

AEA	American Economic Association
AIDS	Acquired Immune Deficiency Syndrome
BEEPS	Business Environment and Enterprise Performance Survey
CAD	comparative advantage defying
CEE	Central and Eastern Europe
CGE	computable general equilibrium
CIDA	Canadian International Development Agency
CIM	competitive industrialization model
CIS	Commonwealth of Independent States
CMH	Commission on Macroeconomics and Health
CSOs	civil society organizations
CSR	corporate social responsibility
DGIS	Directorate-General for International Co-operation (Netherlands)
DHS	demographic and health survey
ECLAC	Economic Commission for Latin America and Caribbean
ECOSOC	(UN) Economic and Social Council
EFF	extended fund facility
FDI	foreign direct investment
FSU	former Soviet Union
FTA	free trade agreement
GSC	global civil society
HDI	human development index
HIPC	highly indebted poor country
HRC	Human Rights Convention
ICT	information and communications technology
IDEA	International Institute for Democracy and Electoral Assistance
IFC	International Finance Corporation
IFI	international financial institution
IFPRI	International Food Policy Research Institute
IMD	Institute for Management Development
IMR	infant mortality rate
INGO	international non-governmental organization
IQR	interquintile ratio
ISI	import substitution industrialization
IT	information technology
LDC	least developed country
LEB	life expectancy at birth
MDG	Millennium Development Goal
MFI	microfinance institution
MFN	most favoured nation

MNC	multinational corporation
NGO	non-governmental organization
NIEO	New International Economic Order
ODA	official development assistance
OLS	ordinary least squares
PCGDP	per capita GDP
PCI	per capita income
ppp	pro-poor policy (Kakwani and Son)
PPP	purchasing power parity
PPS	purchasing power standard
PREM	Poverty Reduction and Economic Management
PRI	Institutional Revolutionary Party, Mexico
PRSP	Poverty Reduction Strategy Paper
PSD	Social Democratic Party, Romania
PTA	preferential trading arrangements
SITC	Standard International Trade Classification
SME	small- and medium-sized enterprises
SOE	state-owned enterprise
SPA	Special Programme of Assistance for Africa
SSA	sub-Saharan Africa
STM	staple trap model
TFP	total factor productivity
TNC	transnational corporation
TOT	terms of trade
TRIP	trade-related intellectual property
TVE	township and village enterprise
UNCED	United Nations Conference on Environment and Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNFPA	United Nations Population Fund
UNSC COMTRADE	United Nations Statistics Division
UNU-WIDER	United Nations University–World Institute for Development Economics Research
U5MR	under five mortality rate
WDI	World Development Indications
WIEGO	Women in Informal Employment: Globalizing and Organizing
WIID	World Income Inequality Database

Legacy – Lal Jayawardena: Crafting Development Policy

*Ajit Singh**

Dr Lal Jayawardena, who died in Colombo in April 2004, was an intellectual, a lover of life and a humane and gifted leader. He was a top Sri Lankan civil servant of the post-independence era and an influential policy-maker. Lal was educated in Sri Lanka and at King's College, Cambridge, where he graduated with a double first in the Economics Tripos. He later did research for his PhD degree, also in Cambridge. He not only excelled academically, but was by all accounts a popular figure among his contemporaries, who included Amartya Sen, Richard Layard, Tam Dalyell, Mahbub ul Haque, Jagdish Bhagwati, Manmohan Singh and Geoff Harcourt. He was an 'apostle' (a member of the famous, select club of undergraduates and dons). He is well remembered by his teachers, particularly Robin Marris and Ken Berrill. He also remained close to one of his Cambridge mentors, the late Nicholas Kaldor, with whom he shared an abiding interest in economic policy making. Lal's contributions were recognized by his college, which bestowed on him an Honorary Fellowship.

He was his country's ambassador to the European Community and to Belgium and the Netherlands between the late 1970s and the early 1980s, and High Commissioner to the UK 1999–2000. During the 1990s he was the principal economic advisor to the President of Sri Lanka and deputized for her as Chair of the National Development Council. Indeed, at one time or another, Lal Jayawardena held almost all the top economic posts in Sri Lanka, having become Treasury Secretary at the very young age of 41. He also had spells as an international civil servant. In this and related capacities he was a serious contributor to the concept of the Third World and he helped create collective organizations to realize the poor countries' demands for a more just international economic order, such as the Group of 77 at the United Nations and the Group of 24 at the IMF, where he served for many years as either Deputy Chairman or Chairman.

Lal Jayawardena was typical of his generation of senior civil servants in many (alas, not all) developing countries: they normally came from the upper crust of their nations but were deeply committed to equity; they were thoroughly professional, proud of their countries but very conscious of the backwardness of their economies. Their forebears may have learned the art of sound civil service from their colonial masters, but Lal and his peers from other developing countries were

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critical of colonialism. They had the self-confidence to believe that they could carry out the tasks of reducing poverty and promoting economic development much better than the colonial governments had done. Over the last 40 years, these diplomats and policy-makers have been deeply involved in fighting for a global regime, which would provide space for developing countries in the world economy.

As a young economist at UNCTAD, Lal was an early and extremely active member of Sydney Dell's study group on the international financial system, which for the first time paid attention to the views and interests of developing countries, as well as the socialist countries of Eastern Europe and Asia. Lal and his colleagues wrote papers which undertook rigorous analyses of international economic issues from a Third World perspective. At the Memorial meeting for Lal in New Delhi in April 2005, Dr Manmohan Singh, the Indian Prime Minister, who was Lal's contemporary at UNCTAD, recalled with pleasure the important work of this group in relation to the establishment of Special Drawing Rights at the IMF. Dr Singh also referred to the setting up of the aid target for advanced countries at 0.7 per cent of GDP. Why 0.7 per cent? The answer, which is buried in the deliberations of this group, is that 0.7 per cent was regarded as being a target for public aid and 0.3 per cent represented private investment (which was the then current level of such investments), giving a total of 1 per cent.

Later, this experience led Lal to become an 'eminent advisor' to the Brandt Commission and a member of his country's delegation to periodic conferences of UNCTAD. Although the credit for creating the entity of the Third World usually goes to the political leaders of the time – Nehru, Nasser, Sukarno, Tito and others – its real architects were dedicated professionals like Lal Jayawardena, Manmohan Singh of India, Mahbub ul Haque of Pakistan, the legendary Raul Prebisch from Argentina, Ken Dadzie from Ghana, Gamani Corea, also from Sri Lanka, as well as many others from around the developing world.

In 1985, Lal was appointed as the first Director of the UN University's World Institute for Development Economics Research (UNU-WIDER) in Helsinki. He was outstandingly successful as Director, helping build within a few years a world-renowned policy think tank focused on the development of poor countries. Under Lal's leadership, WIDER gained rapidly in reputation and compared favourably with scholarly institutions in both international organizations and the academic world. He did this with his unique mixture of intuition, dedication, flair and professional competence. Under Lal, WIDER represented serious, independent and high-quality research. It attracted well-known scholars, including several existing and prospective Nobel Prize winners, as well as top policy-makers from both rich and poor countries. During Lal's tenure as Director, UNU-WIDER published numerous books in the series WIDER Studies in Development Economics, which was established with Oxford University Press (OUP).

Lal was very much a hands-on director in terms of organizing the research agenda and he was a fully engaged academic participant in the research programme. As an economist, Lal continued to work in the international Keynesian tradition and a part of WIDER's research programme was concerned with the renewal and revitalization of this school of thought so as to be of greater relevance to the policy needs of developing countries. This is evident from Lal's own publications, as well as from the invariably thoughtful prefaces he wrote to the many books coming out of WIDER. His own research, as would be expected, was very much concerned with policy issues and specifically the problems of imbalances and asymmetries (both monetary and real) in the international economy. His policy proposals for using the Japanese surpluses in the 1980s for resolving the Third World debt problem and for advancing economic development were widely acclaimed in developing country policy circles, but of course did not win him many friends in the newly converted neoliberal citadels of the Bretton Woods institutions. His 1991 WIDER Research for Action publication, *A Global Environmental Compact for Sustainable Development*, provided the basis for the proposal presented by the United Nations Secretariat to the Rio Earth Summit. Lal also sponsored research at WIDER on Indo-Sri Lanka economic co-operation and in 1993 he co-authored an analysis of the issues and policy proposals for enhancing such co-operation, including a reciprocal preference scheme for promoting trade between the two countries. This scheme was accepted by the two governments and came into effect at the end of 1998 with the signing of the relevant agreements by the prime ministers of India and Sri Lanka.

To sum up, Lal's close friend, the Nobel laureate Amartya Sen, has aptly described him as having the 'rare ability to be energetically sensitive to the predicament of people everywhere in the world' and someone who was 'deeply sympathetic to radical changes and wanted to build a society that would be foundationally more just'.* In Lal's death the world has lost an extraordinary human being.

Appendix

Listed below, in References, are Lal Jayawardena's publications during his tenure as Director of WIDER. Much of his writing during his career was done either for the Sri Lankan government or the international organizations he was working with. For example, he served on groups which advised the UN Secretary General on the Re-structuring of the United Nations system (1975) and on the Re-structuring of Regional Training and Research Institutions in Asia (1978). He also contributed extensively to the work of several important commonwealth study groups, including Reforming the Bretton Woods System (1983) and on the International Debt Crisis and the World Economy (1984). Dr Jayawardena's PhD dissertation was on the subject 'The Supply of Sinhalese Labour to Ceylon Plantations (1830–1930): A Study of Imperial Policy in a Peasant Society' (Cambridge University, 1963). The dissertation was awarded the coveted Ellen McArthur Prize; it has, however, not been published.

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* 'Amartya Sen on Lal Jayawardena'. Address prepared for a colloquium organized by the Global Development Network in memory and honour of Lal Jayawardena. The memorial meeting was inaugurated by Manmohan Singh in April 2005. A summary of the proceedings is forthcoming in *Economic and Political Weekly*.

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Part I

Development Economics in Retrospect

1
The Evolution of the Development Doctrine, 1950–2005

Erik Thorbecke

Introduction

The economic and social development of the Third World, as such, was clearly not a policy objective of the colonial rulers before the Second World War.[1] Such an objective would have been inconsistent with the underlying division of labour and trading patterns within and among colonial blocks. It was not until the end of the colonial system in the late 1940s and 1950s, and the subsequent creation of independent states, that the revolution of rising expectations could start. Thus, the end of Second World War marked the beginning of a new regime for the less developed countries involving the evolution from symbiotic to inward-looking growth and from a dependent to a somewhat more independent relation vis-à-vis the ex-colonial powers. It also marked the beginning of serious interest among scholars and policy-makers in studying and understanding better the development process as a basis for designing appropriate development policies and strategies. In a broad sense a conceptual development doctrine had to be built which policy-makers in the newly independent countries could use as a guideline to the formulation of economic policies.

The selection and adoption of a development strategy – that is, a set of more or less interrelated and consistent policies – depend upon three building blocks: (1) the prevailing development objectives which, in turn, are derived from the prevailing view and definition of the development process; (2) the conceptual state of the art regarding the existing body of development theories, hypotheses, models, techniques and empirical applications; and (3) the underlying data system available to diagnose the existing situation, measure performance and test hypotheses.

Figure 1.1 illustrates the interrelationships and interdependence which exist among (i) development theories and models, (ii) objectives, (iii) data systems and the measurement of performance and (iv) development policies, institutions and strategies, respectively. These four different elements are identified in four corresponding boxes in Figure 1.1. At any point in time or for any given period these four sets of elements (or boxes) are interrelated. Thus, it can be seen from Figure 1.1 that the current state of the art, which is represented in the southwest box embracing development theories, hypotheses and models, affects and is, in

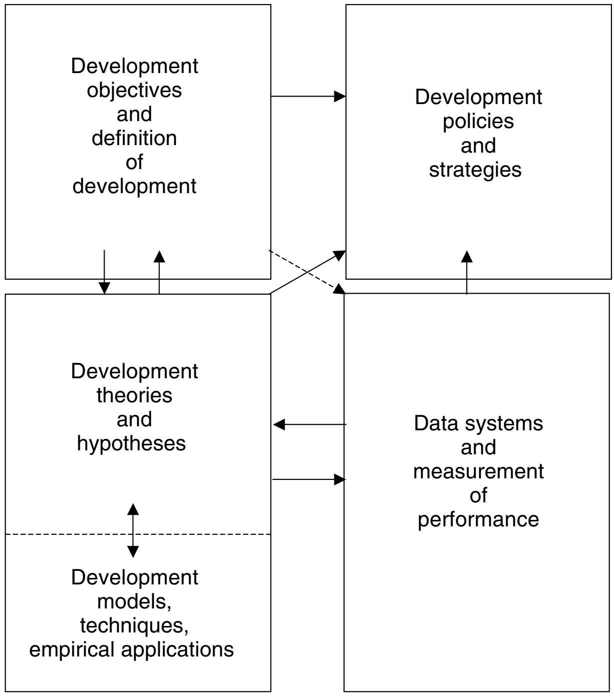

Figure 1.1 Development doctrine: key interrelationships

turn, affected by the prevailing development objectives – hence the two arrows in opposite directions linking these two boxes. Likewise, data systems emanate from the existing body of theories and models and are used to test prevailing development hypotheses and to derive new ones. Finally, the choice of development policies and strategies is jointly determined and influenced by the other three elements – objectives, theories and data, as the three corresponding arrows indicate.[2]

The analytical framework presented above and outlined in Figure 1.1 is applied to describe the state of the art that prevailed in each of the last six decades to highlight in a systematic fashion the changing conception of the development process. The choice of the decade as a relevant time period is of course arbitrary and so is, to some extent, the determination of what should be inserted in the four boxes in Figure 1.1 for each of the six decades under consideration.[3]

Figures 1.2 to 1.7 attempt to identify for each decade the major elements that properly belong in the four interrelated boxes. In a certain sense it can be argued that the interrelationships among objectives, theories and models, data systems and hypotheses and strategies constitute the prevailing development doctrine for a given time period. A brief sequential discussion of the prevailing doctrine in each of the last five decades provides a useful way of capturing the evolution that development theories and strategies have undergone. A final section sums up and concludes.

The development doctrine during the 1950s

Economic growth became the main policy objective in the newly independent less developed countries. It was widely believed that through economic growth and modernization per se, dualism, and associated income and social inequalities that reflected it, would be eliminated. Other economic and social objectives were thought to be complementary to, if not resulting from, GNP growth. Clearly, the adoption of GNP growth as both the objective and yardstick of development was directly related to the conceptual state of the art in the 1950s. The major theoretical contributions that guided the development community during that decade were conceived within a one-sector, aggregate framework and emphasized the role of investment in modern activities. The development economists' tool kit in the 1950s contained such theories and concepts as the 'big push' (Rosenstein-Rodan 1943), 'balanced growth' (Nurkse 1953), 'take-off into sustained growth' (Rostow 1956) and 'critical minimum effort thesis' (Leibenstein 1957) (see Figure 1.2).

What all of these concepts have in common, in addition to an aggregate framework, is equating growth with development and viewing growth in less developed countries as essentially a discontinuous process requiring a large and discrete injection of investment. The 'big push' theory emphasized the importance of economies of scale in overhead facilities and basic industries. The 'take-off' principle was based on the simple Harrod-Domar identity that in order for the growth rate of income to be higher than that of the population (so that per capita income growth is positive) a minimum threshold of the investment to GNP ratio is

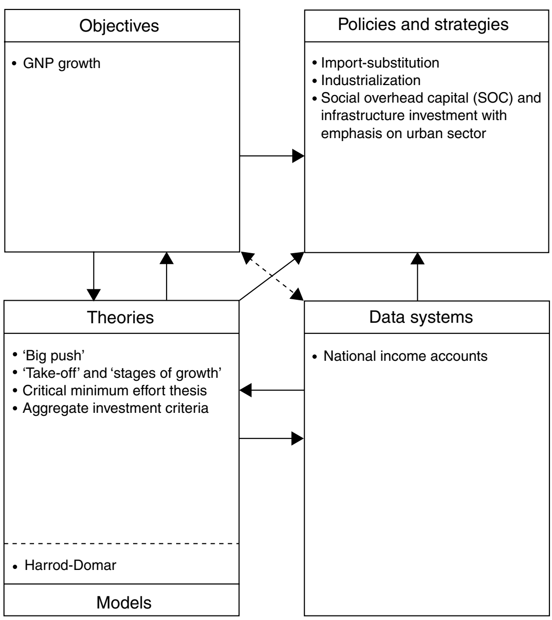

Figure 1.2 Development doctrine during the 1950s

required given the prevailing capital–output ratio. In turn, the 'critical minimum effort thesis' called for a large discrete addition to investment to trigger a cumulative process within which the induced income-growth forces dominate induced income-depressing forces. Finally, Nurkse's (1953) 'balanced growth' concept stressed the external economies inherent on the demand side in a mutually reinforcing and simultaneous expansion of a whole set of complementary production activities which combine together to increase the size of the market. It does appear, in retrospect, that the emphasis on large-scale investment in the 1950s was strongly influenced by the relatively successful development model and performance of the Soviet Union between 1928 and 1940.

The same emphasis on the crucial role of investment as a prime mover of growth is found in the literature on investment criteria in the 1950s. The key contributions were (i) the 'social marginal production' criterion (Kahn 1951; Chenery 1953), (ii) the 'marginal per capita investment quotient' criterion (Galenson and Leibenstein 1955) and (iii) the 'marginal growth contribution' criterion (Eckstein 1957).

It became fashionable to use as an analytical framework one-sector models of the Harrod-Domar type which, because of their completely aggregated and simple production functions, with only investment as an element, emphasized at least implicitly investment in infrastructure and industry. The one-sector, one-input nature of these models precluded any estimation of the sectoral production effects of alternative investment allocations and of different combinations of factors since it was implicitly assumed that factors could only be combined in fixed proportions with investment. In a one-sector world GNP is maximized by pushing the investment-ratio (share of investment in GNP) as high as is consistent with balance-of-payments' equilibrium. In the absence of either theoretical constructs or empirical information on the determinants of agricultural output, the tendency was to equate the modern sector with high productivity of investment and, thus, direct the bulk of investment to the modern sector and to the formation of social overhead capital – usually benefiting the former.

The reliance on aggregate models was not only predetermined by the previously discussed conceptual state of the art but also by the available data system which, in the 1950s, consisted almost exclusively of national income accounts. Disaggregated information in the form of input–output tables appeared in the developing countries only in the 1960s.

The prevailing development strategy in the 1950s follows directly and logically from the previously discussed theoretical concepts. Industrialization was conceived as the engine of growth that would pull the rest of the economy along behind it. The industrial sector was assigned the dynamic role in contrast to the agricultural sector which was, typically, looked at as a passive sector to be 'squeezed' and discriminated against. More specifically, it was felt that industry, as a leading sector, would offer alternative employment opportunities to the agricultural population, would provide a growing demand for foodstuffs and raw materials, and would begin to supply industrial inputs to agriculture. The industrial sector was equated with high productivity of investment – in contrast with agriculture – and, therefore, the bulk of investment was directed to industrial activities and social overhead projects.[4] To a large extent the necessary capital resources to fuel industrial growth had to be extracted from traditional agriculture.

Under this 'industrialization-first' strategy the discrimination in favour of industry and against agriculture took a number of forms. First, in a large number of countries, the internal terms of trade were turned against agriculture through a variety of price policies which maintained food prices at an artificially low level in comparison with industrial prices. One purpose of these price policies – in addition to extracting resources from agriculture – was to provide cheap fuel to the urban workers and thereby tilt the income distribution in their favour. Other discriminatory measures used were a minimal allocation of public resources (for both capital and current expenditures) to agriculture and a lack of encouragement given to the promotion of rural institutions and rural off-farm activities. In some of the larger developing countries, such as India and Pakistan, the availability of food aid on very easy terms – mainly under US Public Law 480 – was an additional element which helped maintain low relative agricultural prices.[5]

A major means of fostering industrialization, at the outset of the development process, was through import substitution – particularly of consumer goods and consumer durables. With very few exceptions the whole gamut of import substitution policies, ranging from restrictive licensing systems, high protective tariffs and multiple exchange rates to various fiscal devices, sprang up and spread rapidly in developing countries. This inward-looking approach to industrial growth led to the fostering of a number of highly inefficient industries.

It should not be inferred that the emphasis on investing in the urban modern sector in import-substituting production activities and physical infrastructure was undesirable from all standpoints. This process did help start industrial development and contributed to the growth of the modern sector. It may even, in some cases, have provided temporary relief to the balance-of-payments constraint. However, by discriminating against exports – actual and potential – the long-run effects of import substitution on the balance of payments may well turn out to have been negative.

The development doctrine during the 1960s

Figure 1.3 captures the major elements of the development doctrine prevailing in the 1960s. On the conceptual front, the 1960s was dominated by an analytical framework based on economic dualism. Whereas the development doctrine of the 1950s implicitly recognized the existence of the backward part of the economy complementing the modern sector, it lacked the dualistic framework to explain the reciprocal roles of the two sectors in the development process. The naive two-sector models à la Lewis (1954) continued to assign to subsistence agriculture an essentially passive role as a potential source of 'unlimited labour' and 'agricultural surplus' for the modern sector. It assumed that farmers could be released from subsistence agriculture in large numbers without a consequent reduction in

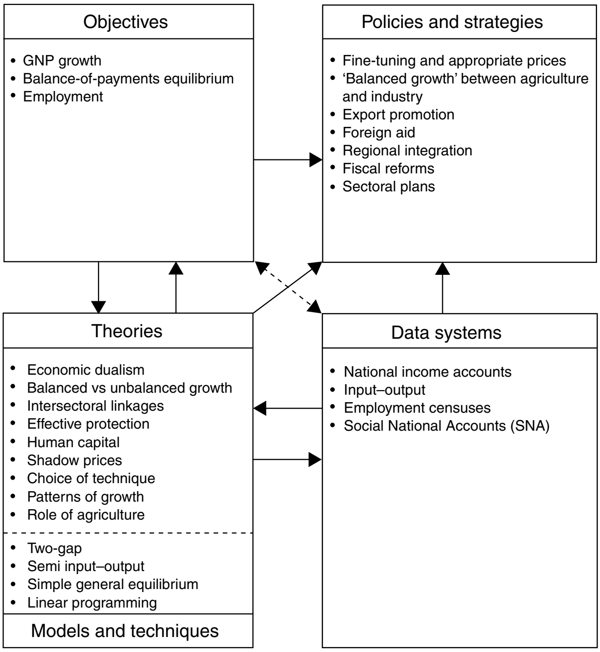

Figure 1.3 Development doctrine during the 1960s

agricultural output while simultaneously carrying their own bundles of food (i.e. capital) on their backs or at least having access to it.

As the dual-economy models became more sophisticated, the interdependence between the functions that the modern industrial and backward agricultural sectors must perform during the growth process was increasingly recognized (Fei and Ranis 1964). The backward sector had to release resources for the industrial sector, which in turn had to be capable of absorbing them. However, neither the release of resources nor the absorption of resources, by and of themselves, were sufficient for economic development to take place. Recognition of this active interdependence was a large step forward from the naive industrialization-first prescription because the above conceptual framework no longer identified either sector as leading or lagging.

A gradual shift of emphasis took place regarding the role of agriculture in development. Rather than considering subsistence agriculture as a passive sector whose resources had to be squeezed in order to fuel the growth of industry and to some extent modern agriculture, it started to become apparent in the second half of the 1960s that agriculture could best perform its role as a supplier of resources by being an active and co-equal partner with modern industry. This meant in concrete terms that a gross flow of resources from industry to agriculture may be crucial at an early stage of development to generate an increase in agricultural output and productivity which would facilitate the extraction of a new transfer out of agriculture and into the modern sector. The trouble with the alternative approach, which appears to have characterized the 1950s, of squeezing agriculture too hard or too early in the development process was described in the following graphic terms: 'The backwards agricultural goose would be starved before it could lay the golden egg' (Thorbecke 1969: 3).

The 'balanced' versus 'unbalanced' growth issue was much debated during the 1960s. In essence, the balanced growth thesis (Nurkse 1953) emphasized the need for the sectoral growth of output to be consistent with the differential growth of demand for different goods as income rises. Unbalanced growth, on the other hand, identified the lack of decision-making ability in the private and public sectors as the main bottleneck to development (Hirshman 1958). The prescription for breaking through this bottleneck was to create a sequence of temporary excess capacity of social overhead facilities which, by creating a vacuum and an attractive physical environment, would encourage the build-up of directly productive activities. Alternatively, the process could start by a build-up of directly productive activities ahead of demand, which, in turn, would generate a need for complementary social overhead projects.

The similarities between the balanced and unbalanced growth theses are more important than their apparently different prescriptions. Both approaches emphasized the role of intersectoral linkages in the development process. In a certain sense they extended the dual-economy framework to a multisectoral one without, however, capturing the essential differences in technology and form of organization between modern and traditional activities. This was at least partially due to the type of sectoral disaggregation available in the existing input–output tables of developing countries during the 1960s. Except for the various branches of industry, the level of sectoral aggregation tended to be very high, with agricultural and service activities seldom broken down in more than two or three sectors. Consequently, any attempt at distinguishing traditional, labour-intensive activities from modern, capital-intensive activities in either agriculture or in service, could not be performed given the classification criteria underlying input–output tables. This example illustrates the interdependence that exists between the prevailing data systems and the conceptual framework in the actual formulation of development plans and strategies. This is an issue that is returned to subsequently.

Another contribution of the late 1960s that was imbedded in intersectoral (input–output) analysis is the theory of effective protection, which clarified and permitted the measurements of the static efficiency cost of import substitution when both inputs and outputs are valued at world prices. Still another important set of contributions that appeared in the 1960s relates to the intersectoral structure and pattern of economic growth. Two different approaches provided important insights into the changing intersectoral structure of production and demand throughout the process of economic development. The first approach, based largely on the work of Kuznets (1966), relied on a careful and painstaking historical analysis of a large number of countries. The second approach was pioneered by Chenery and based on international cross-sectional analysis which was subjected to regression analysis to derive what appeared to be structural phenomena in the process of growth (Chenery 1960; Chenery and Taylor 1968).

The models that were designed in the 1960s can be divided into three types: (i) two-gap models, (ii) semi-input–output models and (iii) simple general equilibrium models. The first type tried to incorporate into a macroeconomic model the role of foreign aid (Chenery and Strout 1966). The underlying logic of these models is that two independent constraints may limit economic growth. The first constraint on skills and savings, if it were the binding one, is described as the investment-limited growth. Alternatively, when the balance-of-payments constraint is effective, trade limited growth would follow. This is a disequilibrium-type model which assumes that developing countries are characterized by limited structural flexibility – with either the investment-savings gap or the balance-of-payments gap binding at any one point in time.

The other types of models (ii and iii above) rely on an intersectoral input–output framework. The semi-input–output method initiated by Jan Tinbergen distinguishes between international sectors, which produce tradable goods, and national sectors, which produce non-tradable goods (Kuyvenhoven 1978). Hence, the required capacity expansion throughout the growth process can be computed for, at least, the non-tradable sectors. The general equilibrium models which appeared in the 1960s were either of a consistency or linear programming type. The main purpose of these models was to throw more light on the intersectoral linkages and the effects of alternative sectoral investment allocations on economic growth (Fox *et al*. 1972; Manne 1974).

The conception of economic development in the 1960s was still largely centred on GNP growth as the key objective. In particular, the relationship between growth and the balance of payments was made clearer. Towards the end of this decade the increasing seriousness of the under- and unemployment problem in the developing world led to a consideration of employment as an objective in its own right next to GNP growth. The most noteworthy change in the conception of development was the concern for understanding better the intersectoral structure and physiology of the development process – as the preceding review of the conceptual state of the arts revealed.

The development policies and strategies that prevailed in the 1960s flowed directly from the conceptual contributions, development objectives and the data system. These policies fall into a few categories, which are reviewed briefly below. The first set embraces the neoclassical prescription and can be expressed under the heading of 'fine-tuning' and 'appropriate prices'. In a nutshell the 'fine-tuning' instruments embrace the use of an appropriate price system (including commodity, tax and subsidy rates), the removal of market imperfections, and appropriate exchange rate and commercial policies. It was expected that these measures would lead to a more appropriate output mix between production activities and input mix, or choice of technique, and thereby generate increased employment.

A second set of policies can be classified as essentially structural, emphasizing the importance of intersectoral linkages. They include the allocation of investment and current public expenditures among sectors, so as to achieve a process of intersectoral balanced (or, in some instances, unbalanced) growth. More specifically, by the late 1960s agriculture was assigned a much more active role in the development process. The provision of a greater level of public resources to that sector – combined with less discriminatory price policies – were expected to result in a growth of output and productivity which would facilitate a net transfer back to the rest of the economy. The success of South Korea and Taiwan in nurturing their agricultural sector and using the agricultural surplus to achieve a successful industrial take-off was starting to resonate.

The development doctrine in the 1970s

Figure 1.4 summarizes the major development objectives, theories, data sources and policies prevailing in the 1970s. By the 1970s the failure of a GNP-oriented development strategy to cope successfully with increasingly serious development problems in much of the Third World led to a thorough re-examination of the process of economic and social development. The major development problems that became acute and could no longer be ignored during this decade can be summarized as:

(i) the increasing level and awareness of under- and unemployment in a large number of developing countries;
(ii) the tendency for income distribution within countries to have become more unequal or, at least, to have remained as unequal as in the immediate post-Second World War period;
(iii) the maintenance of a very large, and perhaps rising, number of individuals in a state of poverty; for instance, below some normative minimum income level or standard of living;
(iv) the continuing and accelerating rural-urban migration and consequent urban congestion; and, finally,
(v) the worsening external position of much of the developing world reflected by increasing balance-of-payments pressures and rapidly mounting foreign indebtedness and debt servicing burdens. Largely as a consequence of these closely interrelated problems a more equal income distribution, particularly in terms of a reduction in absolute poverty, was given a much greater weight in the preference function of most developing countries compared to the objective of aggregate growth per se. Furthermore, this reduction in absolute poverty was to be achieved mainly through increased productive employment (or reduced underemployment) in the traditional sectors.

By the mid-1970s, GNP as a dominant all-encompassing objective had been widely, but by no means universally, dethroned. The presumption that aggregate growth is synonymous with economic and social development or, alternatively, that it will ensure the attainment of all other development objectives, came under critical scrutiny and was rejected in many circles. The launching of the World Employment Programme by the ILO in 1969 signalled that the primary objective should be to raise the standard of living of the poor through increased employment opportunities. The generation of new or greater productive opportunities was considered a means towards the improvement of the welfare of the poor.

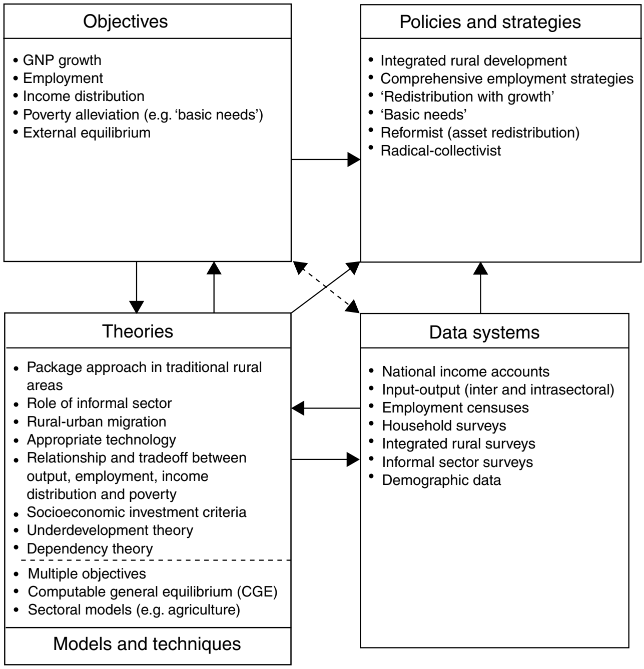

Figure 1.4 Development doctrine during the 1970s

The changing meaning of development as a process that should have as simultaneous objectives growth and poverty alleviation, both influenced and was influenced by a number of conceptual and empirical contributions. The first set of contributions comes under the rubric of integrated rural and agricultural development. A whole series of empirical studies at the micro and macro levels combined to provide an explanation of the physiology and dynamics of the transformation process of traditional agriculture. This body of knowledge provided a rationale for a unimodal strategy in the rural areas, which is discussed subsequently under the strategy box.

A second type of conceptual breakthrough which appeared in the 1970s were those of the informal sector and the role of employment in furthering the development process. Even though the informal sector concept had been around a long time and taken a variety of forms such as Gandhi's emphasis on traditional cottage industries, it became revitalized in a more general and formal sense in the Kenya Report of International Labour Organization (ILO 1972). A number of case studies undertaken by ILO focusing specifically on the role of the informal sector concluded that it was relatively efficient, dynamic and often strongly discriminated against as a result of market imperfections or inappropriate national or municipal regulations. These studies suggested that the informal activities represent an important potential source of output and employment growth. The ILO's World Employment Programme and the World Bank generated much useful empirical research focused on such issues as the relationship between population growth and employment; appropriate labour-intensive technologies; the educational system-labour market–employment–income distribution nexus; the informal sector; the determinants of rural–urban migration and the role of traditional agriculture in the development process.

A third contribution that surfaced in the 1970s includes the interdependence between economic and demographic variables and the determinants of the rural–urban migration. A number of empirical studies, mainly at the micro level, attempted to throw some light on the relationship between such sets of variables as (i) education, nutrition and health and (ii) fertility, infant mortality and, ultimately, the birth rate. The hypotheses that were generated by these studies highlighted the complex nature of the causal relationship between population growth and economic development.

With regard to the determinants of migration, the initial Harris-Todaro (1970) formulation triggered a series of empirical studies and simple models of the migration process. In general, migration was explained as a function of urban–rural wage differentials weighted by the probability of finding urban employment. A somewhat parallel set of contributions at the micro level consists of the attempt at incorporating socioeconomic objectives – such as employment and income distribution – among investment (benefit–cost) criteria and in the appraisal and selection of projects (Little and Mirrlees 1974).

A review of contributions to the state of the art in development economics would not be complete without at least a reference to the neo-Marxist literature on underdevelopment and dependency theories. The essence of these theories is that underdevelopment is intrinsic in a world trading and power system in which the developing countries make up the backward, raw material-producing periphery, and the developed countries the modern industrialized centres (Hunt 1989). A neocolonial system of exploitation by indigenous classes associated with foreign capital (for example, multinational corporations) is considered to have replaced the previous colonial system. After this review of major contributions to development theory, only a few words need be said about the nature of models which appeared in the 1970s. A major characteristic of these models was to explain, at the sectoral and multisectoral levels, the simultaneous determination of output, employment and income distribution. Most of these models were partial in the sense that they did not capture the complete interdependence among these variables.

The coverage and quality of the data available improved substantially in the 1970s as compared to the previous decades. By the mid-1970s, survey-type information on variables such as employment, income, consumption and saving patterns were becoming available. A variety of surveys covering such diverse groups as urban, informal and rural households started to provide valuable information on the consumption and savings behaviour of different socioeconomic groups. In a number of developing countries it became possible, for the first time, to estimate approximately the income distribution by major socioeconomic groups.

After having reviewed the changing development objectives, conceptual contributions and data sources that marked the 1970s, the next logical step is to describe and analyze briefly the new development strategies that emerged. From a belief that growth was a necessary and sufficient condition for the achievement of economic and social development, it became increasingly recognized that even though necessary, growth might not be sufficient. The first step in the broadening process of moving from a single to multiple development objectives was a concern with, and incorporation of, employment in development plans and in the allocation of foreign aid to projects and technical assistance.

One possible attraction of using employment as a target was that it appeared, on the surface, to be relatively easily measurable, in somewhat the same sense as the growth rate of GNP had provided previously a simple scalar measure of development. The real and fundamental issue was an improvement in the standards of living of all groups in society and, in particular, that of the poorest and most destitute groups.

Two partially overlapping variants of a distributionally oriented strategy surfaced during this decade. These were 'redistribution with growth' and 'basic needs'. The first one was essentially incremental in nature, relying on the existing distribution of assets and factors and requiring increasing investment transfers in projects (mostly public but perhaps even private) benefiting the poor (Chenery *et al.* 1974). The first step in this strategy was the shift in the preference (welfare) function away from aggregate growth per se towards poverty reduction. This strategy, which was favoured by the World Bank, focused on the redistribution of at least the increments of capital formation in contrast with the initial stock of assets. Since the bulk of the poor are located in the rural sector and the informal urban sector, this strategy had to be directed towards increasing the productivity of the small farmers and landless workers and making small-scale producers (mainly self-employed) in the informal urban sector more efficient.

The second alternative strategy inaugurated during the 1970s was the basic needs strategy, which was particularly advocated by the ILO.[6] It entailed structural changes and some redistribution of the initial ownership of assets – particularly land reform – in addition to a set of policy instruments, such as public investment. Basic needs, as objectives defined by ILO, included two elements: (i) certain minimal requirements of a family for private consumption, such as adequate food, shelter and clothing and (ii) essential services provided by and for the community at large, such as safe drinking water, sanitation, health and educational facilities.

A complementary policy within the agricultural sector was that of integrated rural development. In a nutshell, the new approach centred on lending and technical activities benefiting directly the traditional sector. This strategy conformed to a broader so-called unimodal agricultural development strategy (Johnston and Kilby 1975). The latter relied on the widespread application of labour-intensive technology to the whole of agriculture. In this sense, it was based on the progressive modernization of agriculture 'from the bottom up'. This strategy can be contrasted with a bimodal strategy, which encourages the growth of the modern, commercial, large-scale, relatively capital-intensive subsector of agriculture while ignoring for all practical purposes the traditional subsistence subsector. Under the unimodal approach, agricultural development was spread relatively evenly over the mass of the people through a combination of appropriate agricultural research and technology, land redistribution, the provision of rural infrastructure, the growth of rural institutions and other measures. This approach was successful in accelerating the output of cereals and invigorating small-scale farms as it was linked to the dissemination of the green revolution technology.

A third type of development strategy follows from the neo-Marxist underdevelopment and dependency theories, which have been previously touched upon. This approach was radical, if not revolutionary, in nature. It called for a massive redistribution of assets to the state and the elimination of most forms of private property. It appeared to favour a collectivistic model – somewhat along the lines of the Chinese regime in power at that time – based on self-reliance and the adoption of indigenous technology and forms of organization.

The development doctrine in the 1980s

A combination of events, including an extremely heavy foreign debt burden – reflecting the cumulative effects of decades of borrowing and manifested by large and increasing balance-of-payments and budget deficits in most of the developing world – combined with higher interest rates and a recession in creditor countries, radically changed the development and aid environment at the beginning of the 1980s. The Mexican financial crisis of 1982 soon spread to other parts of the Third World. The magnitude of the debt crisis was such that, at least for a while, it brought into question the survival of the international financial system.

Suddenly, the achievement of external (balance-of-payments) equilibrium and internal (budget) equilibrium became the overarching objectives and necessary conditions to the restoration of economic growth and poverty alleviation. The debt crisis converted the 1980s into the 'lost development decade'. Before the development and poverty alleviation path could be resumed, the Third World had to put its house in order and implement painful stabilization and structural adjustment policies.

Notwithstanding the fact that the development process was temporarily blocked and most of the attention of the development community was focused on adjustment issues, some important contributions to development theory were made during this decade (see Figure 1.5).

The first one greatly enriched our understanding of the role of human capital as a prime mover of development. The so-called endogenous growth school (Lucas 1988; Romer 1990) identifies low human capital endowment as the primary obstacle to the achievement of the potential scale economies that might come about through industrialization. In a societal production function, raw (unskilled) labour and capital were magnified by a term representing human capital and knowledge, leading to increasing returns. This new conception of human capital helped convert technical progress from an essentially exogenously determined factor to a partially endogenously determined factor. Progress was postulated to stem from two sources: (i) deliberate innovations, fostered by the allocation of resources (including human capital) to research and development (R&D) activities, and

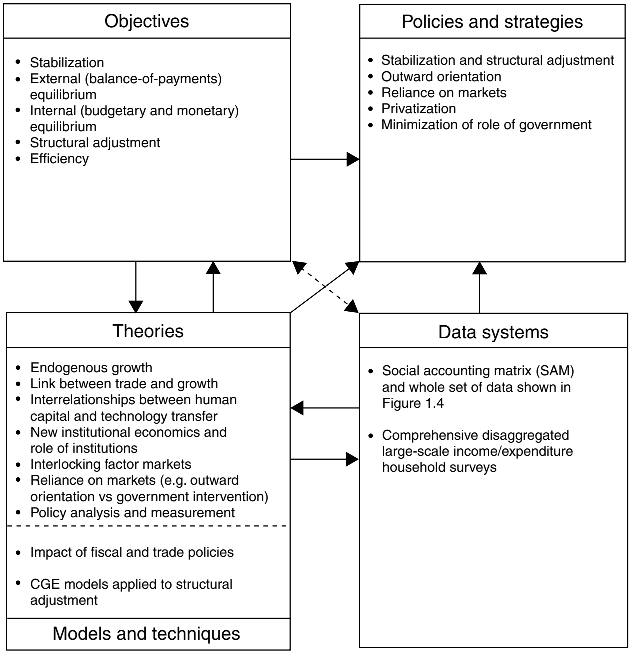

Figure 1.5 Development doctrine during the 1980s

(ii) diffusion, through positive externalities and spillovers from one firm or industry to know-how in other firms or industries (Ray 1998). If investment in human capital and know-how by individuals and firms is indeed subject to increasing returns and externalities, it means that the latter do not receive the full benefits of their investment resulting, consequently, in underinvestment in human capital (the marginal social productivity of investment in human capital being larger than that of the marginal private productivity). The market is likely to under-produce human capital and this provides a rationale for the role of the government in education and training.

A second contribution based on a large number of quantitative and qualitative empirical studies – relying on international cross-sectional and country-specific analyses of performance over time – was the robust case made for the link between trade and growth. Outward orientation was significantly and strongly correlated with growth. Countries that liberalized and encouraged trade grew faster than those that followed a more inward-looking strategy. The presumed mechanism linking export orientation to growth is based on the transfer of state of the art technology normally required to compete successfully in the world market for manufactures. In turn, the adoption of frontier technology by firms adds to the human capital of those workers and engineers through a process of 'learning-by-doing' and 'learning-by-looking' before spilling over to other firms in the same industry and ultimately across industries. In this sense, export orientation is a means of endogenizing and accelerating technological progress and growth.

Furthermore, to the extent that outward orientation in developing countries normally entails a comparative advantage in labour-intensive manufactures, there is much evidence, based on the East and Southeast Asian experience, that the growth path that was followed was also equitable – resulting in substantial poverty alleviation (for a recent survey of the evidence linking trade to growth see Winters 2004).

A third set of contributions that surfaced in the 1980s can be broadly catalogued under the heading of the 'new institutional economics' and collective action (North 1990; Williamson 1991; Nabli and Nugent 1989). As de Janvry *et al.* (1993: 565) noted,

> The main advance was to focus on strategic behaviour by individuals and organized groups in the context of incomplete markets. The theories of imperfect and asymmetrical information and, more broadly, transaction costs gave logic to the role of institutions as instruments to reduce transaction costs.

The neo-institutional framework, in addition to reminding the development community that appropriate institutions and rules of the game are essential to provide pro-development and anti-corruption incentives, also suggested broad guidelines in building institutions that reduced the scope for opportunistic behaviour.

Another contribution of this approach was to provide a clear rationale for the existence of efficient non-market exchange configurations, particularly in the rural areas. Proto-typical examples of such institutions include intra-farm household transactions; two-party contracts (sharecropping and interlinked transactions, for example), farmers' co-operatives and group organizations, mutual insurance networks and informal credit institutions (Thorbecke 1993). Those exchange non-market configurations – called agrarian institutions by Bardhan (1989) – owe their existence to lower transaction costs than those that would prevail in an alternative market configuration providing an equivalent good, factor or service. In most instances market imperfections or, at the limit, market failure (in which case there is no alternative market configuration and transaction costs become infinite) are at the origin of non-market configurations.

The 1980s witnessed some seminal contributions to a better understanding of the concept of poverty and its measurement. A comprehensive and operationally useful approach to poverty analysis was developed by Sen (1985) in his 'capabilities and functioning' theoretical framework. According to this framework what ultimately matters is the freedom of a person to choose her functionings. In order to function, an individual requires a minimum level of wellbeing brought about by a set of attributes. In turn, the Foster-Greer-Thorbecke (1984) class of decomposable poverty measures allowed poverty to be measured while satisfying most important welfare axioms.

A final contribution worth noting – which can be subsumed under the 'new institutional economies' heading – is that of interlinked transactions (Bardhan 1989). An interlinked contract is one in which two or more interdependent exchanges are simultaneously agreed upon (for instance, when a landlord enters into a fixed-rent agreement with a tenant and also agrees to provide credit at a given interest rate). In a more general sense, this type of contract leads to interlocking factor markets for labour, credit and land. In retrospect it is somewhat ironical that during a decade dominated by a faith in the workings of markets – as is discussed subsequently – important theoretical contributions were made that highlighted market imperfections and failures.

Some important contributions to general equilibrium modelling appeared during the 1980s (Dervis *et al.* 1982). These models – calibrated on a base year social accounting matrix (SAM) reflecting the initial (base year) socioeconomic structure of the economy – proved particularly useful in tracing through the impact of a variety of exogenous shocks and policies (such as a devaluation, trade liberalization and fiscal reforms) on the income distribution by socioeconomic household groups. Computable general equilibrium (CGE) models became an important tool to simulate the disaggregated impact of structural adjustment policies on growth and equity. In fact, these models provided the only means to compare the impact of adjustment scenarios to the counterfactual of no- or limited-adjustment scenarios. Since most applied CGEs were built in the 1990s, they are discussed in the next section.

The 1980s witnessed a proliferation of statistical information on a variety of dimensions of development and the welfare of households. Besides more elaborate and disaggregated employment, manufacturing, agricultural and demographic surveys and censuses, large-scale household income and expenditure surveys produced by statistical offices of most developing countries – and often designed and funded by the World Bank (for example, the Living Standard Measurement Surveys) – became available to analysts and policy-makers. Perhaps for the first time, reasonably reliable and robust observations could be derived relating to the magnitude of poverty, the characteristics of the poor and the inter-household income distribution. In turn, the various data sources could be combined to build SAMs of a large number of countries.

The development strategy of the 1970s – centred on redistribution with growth and fulfilment of basic needs – was replaced by an adjustment strategy. The magnitude of the debt crisis and the massive internal and external disequilibrium faced by most countries in Africa and Latin America and some in Asia, meant that adjustment became a necessary (although not sufficient) condition to a resumption of development. The main policy objective of Third World governments became macroeconomic stability, consisting of a set of policies to reduce their balance-of-payments deficits (for example, devaluation) and their budget deficits (through retrenchment). Whereas stabilization per se was meant to eliminate or reduce the imbalance between aggregate demand and aggregate supply, both externally and internally, structural adjustment was required to reduce distortions in relative prices and other structural rigidities that tend to keep supply below its potential. A typical adjustment package consisted of measures such as a devaluation, removal of artificial price distortions, trade liberalization and institutional changes at the sector level.

Complementary elements of the prevailing adjustment strategy of the 1980s included outward orientation, reliance on markets and a minimization of the role of the government. The outward orientation was meant to encourage exports and industrialization in labour-intensive consumer goods. In turn, to achieve competitiveness in exports, vintage technology would have to be imported, which would trigger the endogenous growth processes described previously – investment in the human capital and knowledge of workers and engineers employing those technologies and subsequent spillover effects.

Under the influence of ideological changes in the Western world (for example, the Reagan and Thatcher administrations) developing countries were strongly encouraged, if not forced, to rely on the operation of market forces and in the process to minimize government activities in most spheres, not just productive activities. Inherent contradictions and conflicts arose among the elements of the broad adjustment strategy of the 1980s. The successful implementation of adjustment policies called for a strong government. Likewise, the rationale for a larger role of government in the education sphere to generate the social spillover effects and counteract the under-investment in education by private agents, which do not capture the positive externalities of their investment, ran counter to the objective of a minimalist state. Another conflict was caused by the stabilization goal of reducing the balance-of-payments disequilibrium, while simultaneously liberalizing trade – mainly through elimination of quantitative restrictions and reduction and harmonization of tariff rates. The latter measures would invariably lead to a significant rise in imports that would make it more difficult to restore balance-of-payment equilibrium. Here again, the successful implementation of somewhat conflicting measures called for a strong state.

In this decade, characterized by pro-market and anti-government rhetoric, there was strong sentiment to do away with aid altogether and have private capital flows substitute for it. Thus, in the early 1980s, the Reagan administration created a fertile environment for conservative critics of foreign aid who felt that 'economic assistance distorts the free operation of the market and impedes private sector development' (Ruttan 1996: 143). Clearly, the debt overhang put a damper on going too far in eliminating aid. Both public and private creditors in the industrialized world had too much at stake.

The development doctrine in the 1990s

In the first half of the 1990s, stabilization and adjustment were still the dominant objectives (see Figure 1.6). While most of the Latin American countries (and the few Asian countries affected by the debt crisis) had gone through a painful adjustment process and were back on a growth path, the overall situation was still one of stagnation – largely caused by poor governance in sub-Saharan Africa and most transition economies in Eastern Europe. It was becoming increasingly clear to the development community that fundamental and deep-rooted institutional changes to reduce corruption and facilitate a successful transition from socialism and command economies to market economies were a precondition to successful adjustment and a resumption of development in Eastern Europe and sub-Saharan Africa. Potentially the

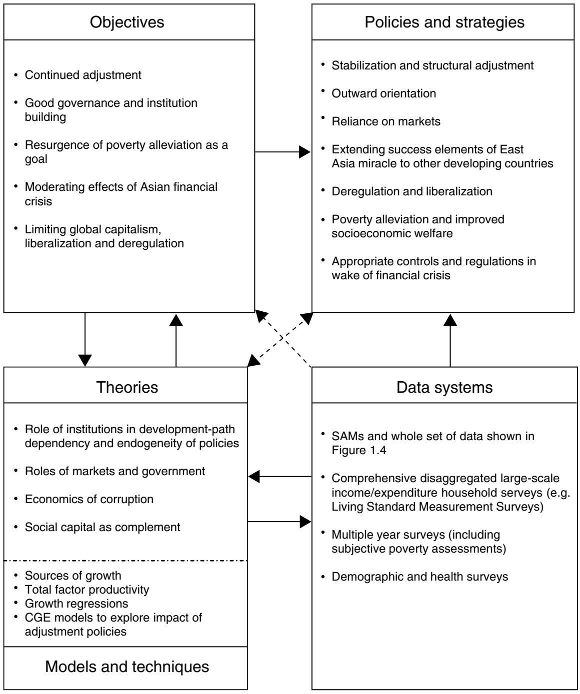

Figure 1.6 Development doctrine during the 1990s

institutions and policies at the root of the East Asian 'miracle' could provide the model to follow.

In the second half of the 1990s the Asian financial crisis hit East and Southeast Asia with a vengeance, resulting in a sharp reversal of the long-term poverty-reduction trend. Simultaneously socioeconomic conditions deteriorated so drastically in the former Soviet republics that poverty alleviation in its broadest sense – including improvements in health, nutrition, education, access to information and to public goods and a participation in decision making – resurfaced as the major, if not overarching, objective of development.

Another consequence of the financial crisis was to bring into question the Washington and IMF consensus of unbridled capital and trade liberalization and complete deregulation of the financial system. A number of East and Southeast Asian countries are still suffering from the extreme deregulation of the banking sector and capital flows that weakened the supervisory and monitoring functions of central banks and other institutions. The international monetary and financial system that still relies on the outdated Bretton Woods 'rules of the game' needs major revamping and a new set of rules befitting the contemporaneous environment. In the meantime, a number of affected countries were restoring controls on an ad hoc basis.

The conceptual contribution to development theory in the 1990s, in general, extended and further elaborated on earlier concepts. Perhaps the most fundamental issue that was debated during the 1990s is the appropriate roles of the state and the market, respectively, in development. An inherently related issue is to identify the set of institutions most conducive to the acceleration of the process of economic growth and socioeconomic development. Prior to the onset of the Asian financial crisis it was felt that the mix of institutions and policies adopted by the East Asian countries that gave rise to the East Asian miracle (World Bank 1993) provided a broad model, with parts of it potentially transferable to other developing countries. The financial crisis led to a more sceptical appraisal – even whether the miracle, after all, was not a 'myth'. In any case, the reliance on government actions in the previous decades to promote industrial growth on the part of East Asian countries (particularly South Korea) appeared suspect and came under heavy criticism. Some critics argued that the already impressive growth performance would have been even better with less government intervention – and that even if those industrial policies had contributed to growth they required a strong state, an element sorely missing in other parts of the Third World.

While the debate on the proper mix between the degree of government intervention and reliance on markets is still very much alive, the neo-institutional and public choice schools have helped clarify how the state can affect development outcomes. This can be done in a number of ways: (i) by providing a macroeconomic and microeconomic incentive environment conducive to efficient economic activity; (ii) by providing the institutional infrastructure – property rights, peace, law and order and rules – that encourages long-term investment; and (iii) by insuring the delivery of basic education, healthcare and infrastructure required for economic activity (Commander *et al.* 1996). Institutional capability as evaluated from the standpoint of entrepreneurs depends, in turn, on such indicators as predictability of rule making, perception of political stability, crime against persons and property, reliability of judicial enforcement and freedom from corruption (Brunetti *et al.* 1997; Chibber 1998).

The role of institutions as a precondition to following a successful development path becomes even more critical if one subscribes to the new approach to political economy that takes institutions as largely given exogenously and argues that policies tend to be determined *endogenously* within a specific institutional context (Persson and Tabellini 1990). Thus, for example, if the central bank and the finance ministry are not independent or are operating under loose discretionary rules, the monetary and fiscal policies that result will depend on political and social factors (or according to the political power of the different lobbies in society and the public choice formulation).

Two additional contributions worth highlighting in this decade are the concept of social capital and a better understanding of sources of growth (total factor productivity) and the need to explain the residual. Social capital was devised as a concept to complement human capital. If individuals are socially excluded, or marginalized, or systematically discriminated against, they cannot rely on the support of networks from which they are sealed off. Alternatively, membership of group organizations brings about benefits that can take a variety of forms (the provision of informal credit and help in the search for employment, for example). The acquisition of social capital by poor households is particularly important as a means to help them escape the poverty trap.

The spectacular growth of East Asian countries prior to 1997 renewed the interest in identifying, explaining and measuring the sources of growth. Recent studies tended to demystify the East Asian miracle by suggesting that the rapid growth of these economies depended on resource accumulation with little improvement in efficiency and that such growth was not likely to be sustainable (Krugman 1994; Kim and Lau 1994; Young 1995). This conclusion was based on estimates of total factor productivity (TFP) growth and depends crucially on the form of the production function used and on an accurate measurement of the capital and labour inputs. Whatever residual is left over is ascribed to technological progress. Some critics argue that typical TFP calculations significantly underestimate organizational improvements within firms or what Leibenstein called X-efficiency (1957).

The 1990s witnessed an increased interest in CGE models used to simulate the impact of exogenous shocks and changes in policies on the socioeconomic system and particularly income distribution. A key issue explored in those models was that of the impact of adjustment policies on income distribution and poverty. General equilibrium models provide the only technique to compare the impact of alternative (counterfactual) policy scenarios, such as a comparison of the effects of an adjustment programme versus a counterfactual non-adjustment programme (Thorbecke 1991 for Indonesia; Sahn *et al.* 1996 for Africa).

This decade was marked by a proliferation of statistical information relating particularly to the socioeconomic characteristics and welfare of households – in addition to the more conventional data sources previously collected (see data box in Figure 1.6). A large number of quantitative poverty assessments based on household expenditure surveys were completed, as well as more qualitative participatory poverty assessments. Furthermore the availability of demographic and health surveys for many developing countries provided micro-level information on health and nutritional status, assets and access to public goods and services to supplement information on household consumption. Also, perhaps for the first time, the availability of multiple-year surveys and panel data for many countries allowed reliable standard of living and welfare comparisons to be made over time.

In many respects, the development strategy of the 1990s was built upon the foundations of the preceding decade and retained most of the latter's strategic elements – at least in the first half of the decade. However, as the decade evolved, the adjustment-based strategy of the 1980s came under critical scrutiny that led to major changes – particularly in the wake of the Asian financial crisis. In sub-Saharan Africa, the great majority of the countries were still facing serious adjustment problems. A widely debated issue was whether adjustment policies per se without complementary reforms – within the context of Africa – could provide the necessary initial conditions for a take-off into sustained growth and poverty alleviation. Two conflicting approaches to adjustment and diagnoses of its impact on performance were put forward. The 'orthodox' view, best articulated by the World Bank (at the beginning of the decade but subsequently modified), argued that an appropriate stabilization and adjustment package pays off. Countries that went further in implementing that package experienced a turnaround in their growth rate and other performance indicators.

In contrast, the 'heterodox' approach – best articulated by the concept of 'adjustment with a human face', embraced by UNICEF (see Cornia *et al*. 1987) – while supporting the need for adjustment, argued that the orthodox reforms focus extensively on short-term stabilization and do not address effectively the deep-rooted structural weaknesses of African economies that are the main causes of macro instability and economic stagnation. Accordingly, major structural changes and institutional changes are needed to complement adjustment policies to induce the structural transformation (such as industrialization, diversification of the export base, the build-up of human capital and even land reform) without which sustainable long-term growth in Africa (and by extension in other developing countries facing similar initial conditions) is not possible.

The UNICEF and heterodox critical evaluation of the impact of adjustment policies on long-term growth and poverty alleviation – even when it was not appropriately justified on empirical grounds – sensitized multilateral and bilateral donors to the need to focus significantly more on the social dimensions of adjustment. It made a strong case for the implementation of a whole series of complementary and reinforcing reforms, ranging from greater emphasis on and investment in human capital and physical infrastructure to major institutional changes – particularly in agriculture and industry – benefiting small producers. In turn, the orthodox approach has made a convincing case that appropriately implemented adjustment policies are not only a necessary condition to the restoration of macroeconomic equilibrium but can also contribute marginally to economic growth and poverty alleviation, in the short run.

In 1993, the World Bank published a very influential report on the East Asian miracle (World Bank 1993). The report analyzed the success elements of the high performing Asian economies and argued that many of them were potentially transferable to other developing countries. In brief, these success elements consisted of:

(i) sound macroeconomic foundations and stable institutions aiming at a balanced budget and competitive exchange rates;
(ii) technocratic regimes and political stability that provided policy credibility and reduced uncertainty – an important factor for foreign investors;
(iii) an outward (export) orientation;
(iv) reliance on markets;
(v) a more controversial set of industrial policies with selective government interventions often using 'contests' among firms as proxy to competition;
(vi) high rates of investment in building human capital;
(vii) high physical investment rates;
(viii) a process of technology acquisition consistent with dynamic comparative advantage; and
(ix) a smooth demographic transition.

In particular, the outward orientation, encouraging exports, was applauded as a means of acquiring state of the art technology which in turn would trigger a 'learning-by-doing' and 'learning-by-looking' (reverse engineering) process that would lead to spillover effects on human capital and positive externalities among firms within an industry and among industries.

The East Asian miracle also provided a convincing example of the essential importance of sound institutions (such as the balanced budget presidential decree in effect in Indonesia between 1967 and 1997) as preconditions to a sustainable process of growth with equity. The absence of institutions appropriate to a smooth transition from command to market economies in much of Eastern Europe and the fragility of existing institutions in much of sub-Saharan Africa provide painful counter-examples of the enormous human costs of a weak institutional framework.

The Asian financial crisis that wrought havoc in much of East and Southeast Asia in 1997 forced a critical re-examination of an international trade and financial system based on excessive trade and capital liberalization and financial deregulation. The large increase in the incidence of poverty that followed in the wake of the crisis sensitized the development community to again focus on poverty alleviation and improvements in the socioeconomic welfare of vulnerable households as the overarching objective of development. Thus, at the end of the decade, the World Bank made it clear that poverty reduction – in its broadest sense – measured in terms of outcomes (health, education, employment, access to public goods and services and social capital) rather than inputs was the primary goal to strive for.

The crisis also triggered a re-examination of the role of government in protecting the economy from major shocks originating abroad. In particular, it pointed towards strengthening financial institutions and the provision of the minimum set of rules and regulations (for example, improved monitoring and supervision of the banking sector) to reduce corruption and speculative borrowing from abroad; and the establishment of institutional safety nets that could act as built-in stabilizers following a crisis.

The decade of the 1990s was marked by a strong and lingering case of 'aid fatigue' evidenced by the absolute decline in net disbursements of official development assistance (ODA) after 1992. This downward trend reflected the strong faith in the operation of markets and scepticism regarding governments' (both aid donors and recipients) involvement in productive sectors such as agriculture and industry. Fatigue was also influenced by the rising fear that foreign aid was generating aid dependency relationships in poor countries and, as such, would have the same type of negative incentive effects that welfare payments have on needy households whose recipients might be discouraged from job searching.

A related issue that was critically debated in the 1990s was that of the effectiveness of aid conditionality. First of all, given fungibility, is it really possible to use aid to 'buy' good policies, or even a sound programme of public (current and capital) expenditures from aid recipients? From the standpoint of the political economy of external aid, structural adjustment can be looked at as a bargaining process between bilateral and multilateral donors, on the one hand, and debtor governments, on the other. Both sides may have a vested interest in following soft rules in their lending and borrowing behaviour, respectively. This tends to foster and continue a dependency relationship that may well be fundamentally inconsistent with a viable long-term development strategy for the recipient countries (particularly in sub-Saharan Africa).

The conditionality debate fuelled a number of econometric studies of aid's effectiveness based on international cross-sectional data. Perhaps the most influential one was that of Burnside and Dollar (2000) which concluded that aid can be a powerful tool for promoting growth and reducing poverty but only if it is granted to countries that are already helping themselves by following growth-enhancing policies. In contrast, Guillaumont and Chavet (2001) find that aid effectiveness depends on exogenous (mostly external) environmental factors such as the terms of trade trend, the extent of export instability and climatic shocks. Their results suggest that the worse the environment, the greater the need for aid and the higher its productivity. Hansen and Tarp (2001), using essentially the same cross-sectional dataset as do Burnside and Dollar, argue that when account is taken of unobserved country-specific fixed effects and the dynamic nature of the aid–growth relationship, the Burnside-Dollar conclusion fails to emerge. Country-specific characteristics of aid recipient countries – aside from the policy regime followed by those countries – have a major impact on aid's effectiveness.

The socioeconomic havoc created by the Asian financial crisis engendered a fundamental re-examination of the role of aid and the uncritical acceptance of rules of the game, based on the outdated international trade and monetary system designed at Bretton Woods and the Washington Consensus no longer consistent with the contemporaneous conditions. Reflective of the trend towards using aid as an instrument to fight poverty is the recent study by Collier and Dollar (1999) that develops criteria for allocating aid when the objective is to maximize poverty alleviation.

Development doctrine in the present decade

It has been claimed with some justification that the development community has run out of 'big ideas' at the beginning of this new millennium. Lindauer and Pritchett (2002), comparing the state of the art in 1962 and 1982 show the amazing reversal of big ideas between the two periods. In 1962 government played a central role and was the driving force behind development, while in 1982 the government was considered to be the main obstacle to development. Similar reversals are noted with respect to the accepted roles of accumulation, trade, foreign capital and foreign aid, respectively, over these two decades. Fast forward to 2002, how would one advise, say, a president of a Latin American country? To quote Lindauer and Pritchett (2002: 2):

> Any push toward deepening market reforms will be seen as a continuation of the failed strategies of the present, while any strategy that calls for government intervention and leadership … will be seen as a reversion to the failed strategies

> of the past. What is of even deeper concern than the lack of an obvious dominant set of big ideas that command (near) universal acclaim is *the scarcity of theory and evidence-based research on which to draw*. (Emphasis added)

It can be argued that the last few years have been marked by a critical re-evaluation and consolidation of previous concepts and techniques as opposed to the formulation of brand new ideas per se. Figure 1.7 summarizes the main development characteristics of this decade. Arguably the most important contribution to development doctrine in this decade is a technique rather than a theory, for instance, the use of randomized and controlled experiments in the evaluation of development effectiveness (Duflo and Kremer 2003). As they argue, 'Any impact evaluation attempts to answer an essentially counterfactual question: how would individuals who participated in the programme have fared in the absence of the programme?' Perhaps the best example of impact analysis is the quasi-experimental design used in evaluating the redistributive PROGRESA programme in Mexico that relied on the selection of target villages (receiving benefits) and control villages (not presently receiving benefits but eligible for benefits in future rounds). Programme effects are estimated by comparing treated individuals or communities to control individuals or communities. There is no question that this new methodology has revolutionized the evaluation of social programmes in such areas as

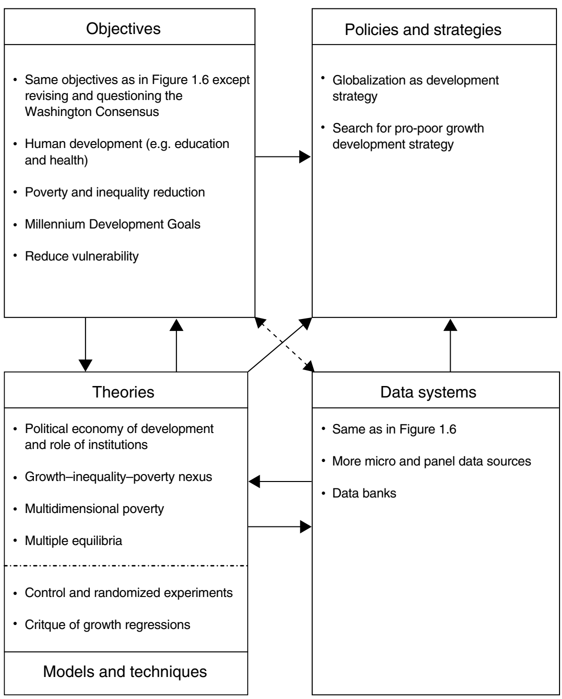

Figure 1.7 Development doctrine during present decade (2000–05)

education and health by providing a scientific base for the recommendations comparable to the design of drug and medical trials. On the other hand the limitation of this approach is that it only provides a precise and robust answer to a very narrow question, 'What is the effect of a specific programme within a specific context?'

Researchers today appear consumed, if not overwhelmed, by what can be called the endogeneity curse or dragon. The emphasis is on combating the econometric biases and problems often to the exclusion of the importance of larger structural and conceptual issues. Controlled experiments have not enlightened us on the underlying mechanisms generating the outcomes. As Mookherjee (2004) points out 'The purpose is not to understand the underlying structure of the system of relationships generating the outcomes, only the statistical outcome impact of certain policy treatments.' Relying on reduced form relations without explicitly identifying and presenting the structural (and behavioural) model yielding the reduced form allows the researchers to by-pass what some would consider a fundamental prior step, namely, the theoretical foundation of the tested hypotheses. Another limitation of impact analysis is that it ignores entirely the general equilibrium effects of an intervention. Given those qualifications, this new methodology has generated a large number of excellent empirical studies of the impact of educational, health and other social interventions in a variety of different settings in poor countries. A recent survey (Glewwe 2002) concludes that this new methodology in the field of education provides an opportunity to make significant progress in understanding what to do in specific situations.

Randomized and controlled experiments appear to have largely replaced structural and behavioural models in the toolkit of development economists. The latter rely heavily on imposed assumptions regarding individual behaviour and rationality and even when econometric results suggest that the imposed structure cannot be rejected, there is no guarantee that a better and still more general model might not exist and reflect observed behaviour more accurately. At the same time the potential strength of those models is that they capture explicitly the underlying structure and behaviour of the agents. It seems that a blending of those two approaches might be quite fruitful as long as it could be done in a fair way consistent with the existing norms and political economy setting. Combining programmes that use some randomization in selecting eligible recipients while also gathering sample survey data on both target and control groups to build structural models could relax somewhat the non-transferability of purely randomized experiments to other settings. Greater use of theory could help explain and clarify the (causal) mechanisms underlying findings generated by controlled experiments and permit a wider range of policy assessments (Mookherjee 2004).

Growth regressions, an important and popular tool of development economists ever since the days of Hollis Chenery, have recently come under heavy criticism. In fact, in an 'obituary for growth regressions' Lindauer and Pritchett (2002) provide many convincing technical reasons for rejecting growth regressions. Their basic flaw is that 'they confuse partial correlations with (stable) parameters and confuse empirical variables (that might be associated with policies) with feasible actions to promote growth'. The right-hand side variables appearing in the reduced form equations – in the absence of an underlying structural and behavioural model actually yielding the reduced form – can be selected on spurious grounds simply because they are correlated with growth. Without an explicit model reflecting the underlying assumed theoretical mechanisms affecting the dependent variable (growth), some critics have dismissed those reduced form regressions as 'right hand side fundamentalism'. The popularity of this approach reflects again a relative lack of theoretical models capable of explaining convincingly the contemporaneous growth process.

On the positive side some important conceptual contributions are flourishing today. The first one can be categorized under the broad theme of the political economy of development and the role of institutions. One of its major tenets is that a more equal initial income and wealth distribution is consistent with and conducive to growth. The new political economy theories linking greater inequality to reduced growth operate through the following channels:

(1) unproductive rent-seeking activities that reduce the security of property;
(2) the diffusion of political and social instability leading to greater uncertainty and lower investment;
(3) redistributive policies encouraged by income inequality that impose disincentives on the rich to invest and accumulate resources;
(4) imperfect credit markets resulting in under-investment by the poor, particularly in human capital; and
(5) a relatively small income share accruing to the middle class – implying greater inequality – has a strong positive effect on fertility which, in turn, has a significant and negative impact on growth.

This new approach turns on its head the prevailing view under the classical framework that an unequal income distribution is a prerequisite to growth, based on the argument that the rich (the capitalists) save a larger proportion of their income than the poor (the workers). Hence, for a given level of total income a more unequal income distribution would generate a larger flow of aggregate savings that could be channelled into investment to yield a higher growth rate of GDP. In this sense the desirability of an unequal income distribution could be rationalized on economic grounds while clashing with the ethical concern for more equality, equity and egalitarianism. More poverty today was a precondition to more economic growth and less poverty in the future. As the Cambridge School baldly put it, impoverishment of the masses is necessary for the accumulation of a surplus over present consumption. If indeed equality is conducive to growth then it becomes a means towards economic development and future poverty alleviation and the conflict between the ethical objective (norm) of egalitarianism and the economic conditions required for growth disappears (Thorbecke 2006).

The new political economy of development approach relies extensively on the role of institutions. In an extremely influential article Acemoglu *et al.* (2001) made a strong case that development depends on institutional quality. They selected an instrumental variable, colonial settler mortality, that affects institutions exogenously but not income directly and were able to explain inter-country differences in per capita income as a function of predicted quality of institutions. Their hypothesis is that mortality rates among early European settlers in a given colony determined whether they would decide to establish resource-extractive or plundering institutions or to settle and build European institutions and, in particular, those protecting property rights. However, as Bardhan (2005) has argued, there are other types of institutions that matter for development such as participatory and accountability institutions and institutions that facilitate investment co-ordination.

A second and related contribution is to understand and explain the growth–inequality–poverty nexus as an essentially indivisible process. Growth is a necessary (but not sufficient) condition for development to occur. If the initial income and wealth distribution is uneven then growth may not only be lower (as proponents of the new political economy of development would argue) but the impact of a given aggregate (GDP) growth rate on poverty reduction will also be significantly smaller (the elasticity of poverty reduction with respect to growth varies within a wide range, between −0.2 and 3.0 depending on the initial conditions). Inequality can be thought of as the filter between growth and poverty.

In addition to the initial income distribution, the pattern and structure of growth play a fundamental role in their impact on poverty. Given the initial conditions, including the institutional framework in place at the time, the outcomes of the nexus of growth, inequality and poverty are jointly determined. This is essentially the theme of the *World Development Report* for 2006 (World Bank 2005) which argues convincingly that there need not be any tradeoff between growth (efficiency) and poverty reduction (equity). The key issue is to identify institutions and policies that are conducive to a pro-poor growth pattern.

A third recent contribution, also interrelated with the above two themes, is a much more comprehensive and multidimensional definition of human welfare than prevailed previously. Building on the foundations of Sen's functioning and capabilities concepts, human development, as opposed to the narrower concept of poverty reduction, has taken over centre-stage as the ultimate goal of development. Human development consists of a plethora of dimensions and aspects as they relate to health, education, nutrition, shelter, access to information, participation, nature of regime (degree of democracy and liberty) and many others. Conceptually, one can think of a human development profile over *n* dimensions. An individual profile would consist of the specific values or scores of that individual on each of the indicators proxying the *n* dimensions. Likewise, one could compute average regional and national profiles. Instead of deriving a scalar value by weighing each of the dimensions (as the UNDP Human Development Index does), complete profiles would be compared.

In some, probably unusual circumstances, one profile could reveal higher (better) values on each of the indicators of the *n* dimensions. In this case the equivalent of first order stochastic dominance would obtain and it could be stated unambiguously that the level of human welfare was higher in the dominant profile. When one profile scores higher on some dimensions but lower on others, no unambiguous ranking can be established without linking each dimension of human welfare to some utility function. It is very difficult if not impossible to imagine that this mapping from dimension to utility can be done totally objectively in a non-arbitrary fashion. In this case, as two profiles intersect, one can check whether second or higher order (stochastic) dominance obtains. Until now the theoretical and empirical work on multidimensional welfare has been focused on and limited to the measurement of multidimensional poverty as opposed to the even broader concept of human development (Bourguignon and Chakravarty 2003; Tsui 2002; Duclos *et al*. 2006). In many respects, this approach goes back to, and represents a much more sophisticated version of the basic needs doctrine of the 1970s. A complementary approach also meant to broaden the concept and measurement of poverty is the attempt at blending objective and quantitative (essentially money-metric) indicators and more subjective and qualitative indicators (à la Sussex School) based on focus groups and interviews (Kanbur 2004).

A final theoretical construct that is presently in vogue and that appears promising in exploring a variety of issues in development economics is that of multiple equilibria. Ray (2000) provides a vivid example drawn from Rosenstein-Rodan's (1943) 'big push' notion and Hirschman's (1958) backward and forward linkages concept. These pioneers argued that economic development could be thought of as a massive co-ordination failure, in which several investments do not occur simply because of the absence of other complementary investments and, similarly, these latter investments are not forthcoming because the former are missing. To quote Ray (2000: 5):

> Thus one might conceive of two equilibria under the very same fundamental conditions, one in which active investment is taking place, with each industry's efforts motivated and justified by the expansion of other industries, and another equilibrium involving persistent stagnation, in which the inactivity of one industry seeps into another. This serves as an explanation of why similar economies may behave very differently.

Institutions and policies might be viewed as tools for moving an economy out of one (bad) equilibrium into another (good) one. In a dynamic sense this process corresponds to a phase transition. If economic development is conceived as one of phase transitions, it carries far-reaching implications for the role of government. Institutions have to be established and policies designed and implemented that facilitate the phase transition. One implication is that the emphasis on temporary, one-time interventions is likely to be much greater and if successful will not have to be repeated. If and once the new (good) equilibrium is reached it is presumably sustainable within the new institutional and policy framework. It would be like jump-starting a car whose battery had run down.

The objectives and definition of development have been further broadened in this decade. As discussed above, improvement in human development is increasingly seen as the ultimate goal to strive for. Since a case has been made that less inequality in the income and wealth distribution can be conducive to growth and future development, greater equality has taken its place along with poverty reduction as joint objectives to be reached through a pattern of growth sensitive to the needs of the poor. The Millennium Development Goals provide a general framework to monitor the progress of the Third World in its search for improving its level of human welfare. Although it is too early to predict confidently, it appears that most of the Millennium Goals have been set at an unrealistically high level and are therefore very unlikely to be attained. There is one more objective that has surfaced recently, namely reduced vulnerability. Since the poor in an era of globalization tend to be more vulnerable to external (essentially macroeconomic shocks) as the Asian Financial Crisis of 1997 demonstrated, it is important to design and implement a set of safety nets and structural measures that would reduce their vulnerability.

The datasets available to the development community are essentially the same as in the previous decade except for the availability of more panel data information useful in tracing the dynamics of poverty and many new cross-country databases on inequality and many other micro and macro variables. Increasingly, data banks are being created by different institutions that can be easily accessed by researchers worldwide.

The formulation of development strategy in this decade has to be scrutinized within the context of a world economy that is globalizing at a very fast rate. A key issue is whether the present form of globalization/integration is conducive to a process of growth-cum-structural transformation, which is capable of engendering and sustaining pro-poor economic growth and favourable distributional consequences. It is possible, contrary to the income convergence thesis, that globalization could generate, both at the national and global levels, adverse distributional consequences that could slow down the present poverty alleviation trend (Nissanke and Thorbecke 2006).

Hence, policy-makers need to design and implement an active development strategy not only to benefit from, but also to help counteract some of the negative effects of the immutable forces of globalization. Globalization should not be viewed as a reliable substitute for a domestic development strategy. It is not enough for governments to assume an active role in liberalizing trade and capital movements and deregulating their economies, while passively waiting for the fruits of the Washington Consensus and the market forces of globalization to pull them on a fast development track. Instead, governments need to pursue both active liberalization and active domestic development policies.

Globalization offers large potential benefits for those countries that decide to engage strategically and actively in the globalization process. Benefits are neither automatic nor guaranteed. Passive liberalization may lead to marginalization. At the same time those countries that are still stagnating (most of sub-Saharan Africa) need to strengthen institutions as well as to invest in agriculture in order to reach the take-off point for structural transformation of their economies to proceed.

Conclusions

The retrospective appraisal revealed the close interdependence and evolution among development objectives, the conceptual framework and models, data and information systems, and development strategies throughout the last six decades. In each period the nature and scope of the prevailing development strategy was influenced, and sometimes predetermined, by the conceptual state of the art and the available data systems. The interdependent evolution among the four elements of the development doctrine can perhaps best be brought to light by the gradual progression which these elements underwent through time. The definition of development broadened from being tantamount to GNP growth, as both an objective and a performance criterion, to growth and employment, to the satisfaction of basic needs and, ultimately, to the enhancement of human welfare and the reduction of multidimensional poverty to be achieved through a pattern of pro-poor growth. Thus, development evolved from an essentially scalar concept to a multidimensional one entailing the simultaneous achievement of multiple objectives.

A parallel progression occurred in development theory. During the 1950s the analytical framework was completely aggregative and relied on one-sector models. In the 1960s the prevailing framework became dualistic, distinguishing between an urban, modern-industrial sector and a rural, traditional-agricultural sector. Gradually, as distributional issues became paramount major breakthroughs in the analysis and measurement of poverty occurred. A concern for structural issues early on gave way to a concern with the role of institutions and the market in the development process. The somewhat idealized and misplaced faith in planning which characterized the early decades was replaced by an arguably controversial over-reliance in the effectiveness of markets as an engine of development and as a corollary the minimization of the role of governments. Endogenous growth requires governments capable of intervening in areas such as education and health to yield the spillover effects of investment in human capital on overall development. In the present era of globalization the appropriate roles of governments and markets is one of the most debated issues.

The advance in the coverage and quality of the data and data systems needed for development analysis and policy over the last half century as been remarkable. Until the 1970s the statistical information available to researchers and government offices consisted almost exclusively of national accounts, population, agricultural and manufacturing censuses and, in a few instances, simple input–output tables. Survey-type information on variables such as employment, income, consumption and savings patterns tended to be scarce and not very representative. Thus, in general, the existing data systems were not conducive to empirical studies that could illuminate such fundamental issues as the state of income distribution and the incidence of poverty. From the 1980s on, the coverage of household survey data expanded enormously and allowed a plethora of microeconomic studies to be conducted on a large variety of issues related to human welfare such as health and education. In turn, the evolution in the quality and comprehensiveness of social accounting matrices worldwide provided a necessary bridge between the macro- and the microeconomic settings. Computable general equilibrium models and macro–micro simulation models made it possible, within limits, to estimate the impact of macroeconomic policies and shocks on the earnings and incomes of different socioeconomic household groups and even, in some instances, on individual households. The parallel progress in theoretical concepts and in data systems opened up the domain of distributional issues to more rigorous investigation.

Notwithstanding a possible shortage of 'big ideas' in the present decade, we can agree with Bardhan's (1993: 139–40) conclusion, in his assessment of the state of development economics, that

> While the problems of the world's poor remain as overwhelming as ever, studying them has generated enough analytical ideas and thrown up enough challenges to the dominant paradigm to make all of us in the profession somewhat wiser, and at least somewhat more conscious of the possibilities and limitations of our existing methods of analysis.

Notes

1. This chapter is based on and updates an earlier study by Thorbecke (2000).
2. There are two additional reciprocal relationships denoted by arrows in Figure 1.1. The first one is the interaction between development theories and hypotheses and development models. Models are typically based on theoretical hypotheses, which often are of a partial nature. By integrating various hypotheses into a consistent framework, which the model provides, some new insights may be derived which could lead to a modification of the initial hypotheses. The second bi-directional arrow is the one linking development objectives and data systems. Clearly, the choice of development goals both predetermines the kind of data system that is required and is affected by it. Many concrete examples of these interrelationships are described and analyzed next in the application of the conceptual framework in Figure 1.1 to the five decades spanning the period 1950–2005.
3. In particular, certain conceptual and theoretical contributions may have been formulated before they became part of the conventional wisdom. An example of this is the seminal article of Lewis (1954), which triggered the economic dualism concept that became a major element of the development paradigm of the 1960s rather than of the 1950s.
4. Here again the emphasis on industrialization was greatly influenced by the Soviet model.
5. Public Law (PL) 480 refers to the Agricultural Trade Development and Assistance Act passed in the United States in 1954, marking the inception of food aid programmes.
6. Far from originating with ILO, the concept of basic needs and planning for poverty alleviation had already been expressed and formulated very clearly by the Indian planner Pitambar Pant as early as 1962 (see Pant 1974).

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2
Turning Points in Development Thinking and Practice

Louis Emmerij

A turning point in the balance of thinking and influence

In this study, I first examine why and how the balance of development thinking and practice changed around 1980. This turning point coincided with a change of influence at the level of strategic thinking from the UN to the Bretton Woods institutions. Second, I look into the possibility of future turning points in development thinking and practice. In doing so, I describe, first, what could well become (and is already becoming) a new and expanded general concept of development and, second, the very opposite, namely development not as a global but as a regional and local strategy. Thus, having examined the future at the global, regional and national levels of development thinking, the study ends with reflections about the interests that lie behind the ideas that help to explain why they get implemented or not, why there are turning points or not.

During the 1940s and 1950s the UN was *the* place where big ideas about economic and social development policies were initiated. This continued during the 1960s and 1970s with the initiation of the UN Development Decades, the unified approach of the United Nations Research Institute for Social Development (UNRISD) and the elaboration of employment and basic needs-oriented development strategies by the ILO. It was in this connection that Hans Singer discovered the concept of 'redistribution from growth' during the Kenya High-Level Comprehensive Employment Mission (ILO 1972). During the 1970s the World Bank entered the scene of alternative thinking about development thanks to Hollis Chenery who elaborated and systematized the Singer analysis setting it into a broader statistical framework using data banks and analytical resources from the World Bank. He changed the title in the process from redistribution *from* growth to redistribution *with* growth (Chenery *et al*. 1974).

All this changed at the end of the 1970s with a harsh reversal of economic policies followed hitherto and a move towards neoliberal and neoclassical policies that emphasized privatization and liberalization. This policy reversal was soon followed in all OECD countries and became the conventional wisdom of the West. Contrary to what the innocent bystander might have thought at the time, this 'new' orthodoxy did not come out of the blue. Turning points rarely come out the blue. It had been prepared carefully over time by a core of neoclassical economists. Indeed, the 1970s saw the emergence of two opposing trends in development thinking. One trend consisted in widening the scope of the development strategies pursued by explicitly including social considerations, such as education, health, nutrition, employment, income distribution, basic needs, poverty reduction, environmental considerations, gender and so on. The other trend was represented by a return to neoclassical thinking. And so, as development thinking during the 1970s became more comprehensive and more poverty- and income distribution-oriented, the groundwork was laid by the followers of the neoclassical and neoliberal approach that was to become the 'new' paradigm of the 1980s and beyond. For example, the criticism of import substitution became more precise, technical and empirical (Little *et al.* 1970). This early work was followed by other studies that represented an important strengthening of the theoretical framework of the open-economy model. The same reasoning applies to the monetarist strand of the neoclassical resurgence.

This new paradigm was of course a recycled version of trickle-down economics, with growth given greater weight than income distribution and social objectives. The underlying hypothesis was that policy reforms designed to achieve efficiency and growth would also promote better living standards, especially for the poorest. The social costs of structural adjustment were inconvenient but temporary; in any case they were inevitable in order for countries to return to more rational and viable economic structures. Not only did this 'new' orthodoxy become the economic strategy of the West but, through its adoption by the World Bank and the IMF it became the conventional wisdom of practically the entire globe, whether voluntarily or not. The (important) exception here were the East Asian countries that went under a variety of labels, such as the Asian Tigers, the Flying Geese, etc.

The Bretton Woods institutions adopted the reversal of policies because the Western countries could impose their will in the Board, given the weighted voting system. Once adopted, they (that is, the Bretton Woods institutions and Western countries) could impose it on the rest of the world – also in the light of the international debt crisis. It was a typical case of the power of the purse versus the power of ideas. The purse won mainly, we contend, because of the absence of ideas on the part of the UN and the rest of the world during this period, with the exception, once again, of East Asia.

But, it can be asked, where had all the Nobel laureates gone who had been so instrumental in the early years to shape development thinking both in the UN and in the world at large? In 1980 most of them were still very much alive. Jan Tinbergen, Gunnar Myrdal, W. Arthur Lewis, Richard Stone, James Meade, Amartya Sen and others were still very active. But no consistent counter-offensive was mounted in the early 1980s. True enough, hundreds of British economists[1] signed their rejection of Thatcherite economics, but with little effect on practical policy or ideological stance. And so the purse won mainly because the existing ideas of the 1970s were not defended and adapted strongly and carefully enough and no alternative ideas were brought forward in a sufficiently authoritative fashion. We had to wait until the 1990s for this to happen – in terms of thinking rather than of practice – when the series of *Human Development Reports* were launched by Mahbub ul Haque and his small team at the United Nations Development Programme (UNDP).[2]

The future of development as a global concept

What is amazing when it comes to development thinking is the dominance of Western ideas. Starting with modernization theory, all the development approaches are 'Western' and are dominated by economists. This remains true even with strategies conceived by thinkers from the South or the East.

The classicists and the other great names in development thinking were all from Europe and secondarily from the United States. Development thinking in the modern era, since 1945, saw a wider cast of characters come to the fore, but it remained a global concept that was not 'deconstructed', to use Escobar's (1995) terminology. The labour-surplus model, the 'big push', balanced and unbalanced growth, great spurt and stages of economic growth doctrines were all of European and American extraction. The only person from a developing country – W. Arthur Lewis – did not depart from his neoclassical upbringing.

The same applies to the Marxist school of thought, although to a lesser degree. For instance, Paul Baran saw European colonialism interfering not only with development in the pre-capitalist colonies but modifying their future development path as well. His analysis points to the asymmetrical power and political relations – rather than God-given 'natural endowments' and free market-determined 'comparative advantages' – in determining the growth path followed by many underdeveloped countries. Baran (1957) concluded that 'far from serving as an engine of economic expansion, of technological progress, and of social change, the capitalist order in these countries has represented a framework for economic stagnation, for archaic technology and for social backwardness'. Baran and Sweezy (1966) inverted the law of uneven development on a worldscale relative to the formulations of the classical Marxist analysis of imperialism: rather than slowing down the accumulation in the advanced countries, imperialism blocked development in the less developed economies. The internal dynamics of underdeveloped societies came to be seen as fundamentally determined by their insertion into the world capitalist system. Although their analysis was pertinent and interesting, their suggestions for setting up an alternative development approach remained highly tentative and defensive and not really departing from its Western origins.

What is 'Western' about all this is that no account is taken of local thinking in and local theorists of developing countries. A possible exception is Raul Prebisch and the Latin American Structuralist school that emerged in the late 1940s. Here development and underdevelopment are seen as related processes occurring within a single, dynamic economic system. Development is generated in some areas – the centre defined as those countries whose economies were first penetrated by capitalist production techniques – and underdevelopment is generated in others – the periphery. Modern underdevelopment is therefore seen as a result of a process of structural change in the peripheral economies that occurs in conjunction with – is conditioned by, but not caused unilaterally by – their relations with the centre (Prebisch 1950). So even here the Western influence is important, as it is in the writings of Cardoso and Faletto (1979), Samir Amin and others of the *dependencia* school.

The neoclassical resurgence we have observed since 1980 is of course totally Western bred, but so were the redistribution with growth and the basic needs development strategies of the 1970s. Although the latter did explicitly take into consideration the specific circumstances of the developing countries, they remained embedded in Western concepts and thinking.

The events of the past decades challenge much of the validity of these Western development theories, whether liberal or Marxist, neoclassical or post-Keynesian. They did not anticipate turning points, collapses or failures; neither did they explain them ex post. They do not explain why so many countries do not seem to be able to take off economically or are regressing to previous levels of economic development. They do not explain either the 'ennui' in the apparently successful countries. Examples are the totally unanticipated collapse of communism and the reintegration of Central and Eastern Europe and the former Soviet Union into the capitalist world economy. Nor do they give an explanation of the reappearance of virulent nationalism and ethnic conflicts as well as the rapid growth of militant religious fundamentalism in both Western and non-Western societies. The economic stagnation and decline in African and Latin American countries; the imposition and the lack of success of structural adjustment programmes, especially in Africa, the rapid state-led industrialization of the East Asian countries cannot be explained by any rational criteria of the Washington Consensus school. Hence, all of those were on the whole not anticipated by either mainstream or more radical theories of development. In the face of such a failure to foresee major changes it can be maintained that we are witnessing a crisis in development theory even if in practice many stress the average progress achieved.

None of the theories – whether of the modernization, dependency, neoliberal or Marxist variety – seems to be working in the sense that each one runs into trouble, even if initial successes were secured. During the 1980s and 1990s these theories have been supplanted by a hegemonic neoliberal view of development based on 'globalization', 'free markets' that effectively dismiss questions of ethnicity, of culture, and does not try to understand nationalism, fundamentalism and terrorism. It can be maintained that the whole Western model of development, the 'paradigm of modernity', of a secular, industrial nation-state, is now in question and that a coherent and persuasive alternative model is yet to be found.

It would appear obvious that within the global economy enough flexibility must be created to make room for regional and national variations towards development policies, given the specific situation of the region or country in question. For instance, it can hardly be maintained that the Washington Consensus has been a success story in Latin America. In 1996, Ajit Singh challenged his Latin American colleagues to say how much more time they needed before being able to say that the Washington Consensus has been a failure. 'Five more years', they answered.[3] Five years later the picture was as follows: Argentina was in turmoil, President

Menem under house arrest, his successor and two more presidents gone by the wayside; Fujimori was in Japan and his country Peru in trouble; the Mexicans have not waited five years to oust the PRI in power for practically the entire twentieth century, although it is not all clear whether Vicente Fox has been able to find his own way; the Venezuelans sacked the traditional parties who squandered the oil revenues and replaced them by a populist Hugo Chavez; and we could go down the tragic list, from Colombia to Brazil via Ecuador. What lessons can and must be learned from all this?

Towards a new and flexible concept of development: forks in the road

There are two questions that one must ask when it comes to development theory and practice. The first is whether the approach adopted up until now is comprehensive enough or still too narrowly economistic; the second relates to the problem of homogeneity, i.e. in how far must development policies be adapted and changed according to the culture of a given region or country. In other words, the question before us is whether there is one theory and one practice for the entire world, with a little tinkering at the margins to take account of regional differences, or whether there should be many theories and many practices in order to tailor-make development policies according to the culture and habits of countries and regions. So far the former approach has been adopted with mixed results. This approach is now being finessed and broadened and we shall start this section presenting the state of play. The latter approach must be given more thought, as we will show. We are facing a fork in the development road.

Broadening development theory and practice

Amartya Kumar Sen, the 1998 Nobel Prize laureate, has given this problem a lot of thought and has come to the conclusion that a universal approach is desirable, as long as development thinking covers a wider surface by bringing on board political, cultural, social and human rights issues. One illustration of this belief is the importance he attaches to tolerance and pluralism, of democratic procedures in short: 'To see political tolerance merely as a "Western liberal" inclination seemed to me a serious mistake.'[4] Sen has always adopted a broad approach to development, including work on economic inequality, poverty, employment, technology, investigating the principles and implications of liberty and rights, assessing gender inequality, etc. In other words, his interest gradually shifted from the pure theory of social choice to more 'practical' problems (Sen 1982; 1984).

Subsequently, Sen (1985) started to explore an approach that sees individual advantage not merely as opulence or utility, but primarily in terms of the lives people manage to live and the freedom they have to choose the kind of life they have reason to value. The basic idea here is to pay attention to the actual 'capabilities' that people end up having. He elaborated his work on poverty by coming up with a universal definition, not of course in terms of purchasing power but of capabilities and functionings. The poor are poor because their set of capabilities is small, not because of what they do not have, but because of what they cannot do. This measure is universal because it entails identifying a set of capabilities, something like basic needs. A minimum list would include being able to lead a healthy and productive life, to communicate and participate in your community, to move about freely and to have a family with a partner of your choice.

Thus, Sen has elaborated a distinct agenda. Utility and income have been displaced from their primary positions in orthodox economics. Wellbeing is captured by things people can do rather than things people have. If their set of capabilities grows larger, people can do more of the things they would like to do. And so we arrive at a new and dynamic definition of freedom; choice over a larger set of capabilities (Desai 2000). Sen's (1999) emphasis on freedom of choice led him naturally to attach prime importance to democracy as a preferred political system: 'A country does not have to be deemed fit *for* democracy; rather, it has to become fit *through* democracy.'

But what exactly is democracy? Sen asserts that we must not identify democracy with majority rule. Democracy does, of course, include voting and respect for election results, but it also requires the protection of liberties and freedoms, respect for legal entitlements, and the guaranteeing of free discussion and uncensored distribution of news and fair comment. 'Even the idea of "needs", including the understanding of "economic needs", requires public discussion and exchange of information, views, and analysis' (*Ibid.*: 10).

Thus, Amartya Sen does not quite trust unadulterated market economics, is in favour of democratic decision making and calls for social support in development. He has been arguing in favour of softer, gentler and more humane economics and economic policies. When he was awarded the Nobel Prize in 1998, he was credited by the Royal Swedish Academy with 'having restored an ethical dimension to economics'. He points out that in the classical writings on development it was always assumed that economic development was a benign process, in the interest of the people. The view that one must ignore any kind of social sympathies for the underdog, and that you cannot have democracy, did not become the dominant thought until the beginning of modern development economics, say as of the 1950s.[5] Sen elaborates on the notion of development viewed as 'fierce' as opposed to seeing it as a 'friendly' process. The former asks for a 'needed sacrifice' in order to achieve a better future. This approach, with its emphasis on capital accumulation, is not wrong, but suffers from several handicaps mostly relating to the comparative neglect of the wellbeing and quality of life in the present and near future. Sen (1997: 537) concludes:

> Those who see in this a model to follow have continued to argue for giving priority to business … interests so that the productive power of the nation can be radically expanded, and they warn against the spoiling of long-run benefits by the premature operation of sympathy; they are terrified of the harm that may result from the influence of 'bleeding hearts'. The 'friendly' approach, by contrast, sees development as a process where people help each other and themselves with an emphasis on human skills and human capital, and on the

> role of human qualities in promoting and sustaining economic growth. Ultimately, the focus is on the expansion of human freedom to live the kind of lives people have reason to value. And, thus, the role of economic growth in expanding these opportunities has to be integrated into that more foundational understanding of the process of development.

And so we have been moving towards a global concept of development in which physical and human capital accumulation remain important ingredients, but where social objectives, freedom, democracy, ethnicity, human rights are becoming at least as crucial. It took time to realize that education is not just a consumption good that can be afforded as of a certain level of development, but that it is also an investment in human capital that is a prerequisite to *attain* that level of development. In the same way, we must now get used to the idea that social and ethnic inequalities, absence of freedom and democracy are as much reasons for lack of development as absence of investments. The concept of development not only becomes much more comprehensive and all embracing, but also the causative links and relationships are being reversed. This line of thought also underlies the concept of human development, initiated by ul Haque (with the active assistance of Sen) in the *Human Development Reports* mentioned earlier.

Obviously, it can be argued that the 'Sen approach' to development must be more formally formulated in terms of an economic and social development model. Physical and human capital investments, sector allocation, human rights, freedom, etc. must be integrated in a consistent whole in order to move away from words and towards a formal model.

Breaking down development nationally, locally and culturally

There is a growing awareness of the importance of culture in the development process and of the cultural assumptions inherent in development theory and practice. The preceding section is based on the assumption that by broadening the concept of development the range of development models becomes progressively narrower. But the question that is being asked today is whether development models are determined culturally by each region, or by the culture of one region, namely the West.[6] Culture will be defined here in a broad sense, as a way of life and living together. This relates to values people hold, to tolerance with respect to others (race, gender, foreigners), to outward versus inward orientations and inclinations, etc.

More cultural freedom leaves us free to meet one of the most basic needs, 'the need to define our *own* basic needs' (UNESCO 1995: 15). But defining one's own basic needs is one thing, the way to attain them, through which social and economic policies, for instance, is another. We must be careful to maintain a balance between universalism and localism and avoid moving from one extreme to another. The thesis of those who are in favour of more variety in development policies linked to local cultures, institutions and habits, goes somewhere along the following lines:

(i) Western culture has held an iron grip on development thinking and practice;
(ii) this influence has tended to increase further during the past twenty years; but
(iii) there do exist alternative development models based on a different cultural and institutional historical background; and
(iv) these alternatives are likely to multiply in the era of globalization that may, therefore, paradoxically witness more diversity rather than uniformity.

Examples of such variations in development policies can be given. The Japanese and other East Asian authorities have always maintained that globalization does *not* imply that a universal model or uniform set of rules – as for instance implied in the Washington Consensus, but also in Sen's much broader concept – spread to all parts of the world. According to one Japanese authority (a hard-nosed top official of the Ministry of Finance who went under the nickname Mr Yen) 'we have to recognize that what can be called localization, or an identification with local cultural values, is proceeding along with globalization' (Sakakibara 1997). As was implied earlier, most neoclassical economists tend to apply their 'universal' model unilaterally to all countries, neglecting the historical, institutional and cultural backgrounds of the countries in question. But there are doubters who recognize the plurality of economic systems or cultures and emphasize the interaction among them. For them the key concept is not universality, but diversity and interaction.

For instance, it has been argued by many economists that deregulation must be implemented as intensively as possible, simultaneously and quickly on many fronts. But such an approach implicitly assumes that Anglo-American institutions are already in place or can be quickly established by enlightened reformers with the help of consultants and international organizations. This neglect of the validity of different cultures and evolutionary processes of history has often led to confusion and the collapse of the existing order rather than to reform. How can proper macroeconomic policies be conducted if the necessary infrastructure such as a central banking system and an effectively governed enterprise system do not exist? Forcing a uniform model on diverse country and cultural situations may endanger the economic future of these countries, as well as that of the world at large.

The need for a differentiated approach has long been obvious, in view of the remarkable success of the East Asian development experience. This need is also felt because of the disquieting fact that in most countries that have adopted the current economic orthodoxy (read Washington Consensus) during the past 20 years or so, the distribution of income has worsened, poverty has tended to increase and employment trends have been very uneven. The causal linkages have not yet been well understood, but the association between the adoption of a specific uniform model and the accentuation of problems of inequality and poverty is a cause for serious concern. If one of the priorities is 'to bring the millions of dispossessed and disadvantaged in from the margins of society and cultural policy in from the margins of governance' (Council of Europe 1996: 9), then bringing these two together by adapting the development models according to the needs, institutions, history and culture of different societies is an absolute must. The margins of manoeuvre may not be huge, but wider than one might suspect at first sight. That much has become clear from the East Asian development experience. These margins refer to institutions, consumption habits, land rights, property rights in general, access to markets, distribution systems, economic democracy, etc. The growing internationalization and globalization may provoke diversity at least as much as imposing uniformity.

Participation and empowerment are, obviously, closely related to both cultural and economic rights and equality. Participation, a human right, is one of the key objects of cultural and economic policy, because it opens up both the economy and culture to as many people as possible. It is often forgotten that East Asian countries could only grow at such stupendous rates of 8–9 per cent a year over such a long time *because* there was full employment, that is, everybody participated actively in the economy. In other words, there was growth from below. One cannot expect countries to grow much beyond 3–4 per cent until the bottom half of the population is participating and contributing. 'The issue is not so much that of growth with distribution; growth with distribution can be achieved by a few cooks preparing a pie and distributing the pieces to a larger group through transfers. It is instead a matter of the poor becoming cooks too, and of more cooks preparing a bigger pie' (Birdsall: 1997: 394–9). For the 'poor' one can and must read immigrants, women, unemployed, certain ethnic groups, etc.

East Asia can be seen as a mild case of economic differentiation from the mainstream. It was less based on theory than on actual practice. There is, however, a school of thought that wants to go further. This school is best illustrated by the 'decontructionist' approach of Escobar (1995). What this school is pleading for is differentiated development policies based on the cultural, institutional and historical characteristics of a given region as determined by the participation and empowerment of the people. It is a bottom-up approach pushed to its extreme. However, if an extreme approach is discarded, what remains is an important policy alternative, namely the desirability to include local variations on the national, regional and global development theme. The 'realistic' approach here takes as a starting point the alleged fact that development policies are to a very large extent top-down, ethnocentric and technocratic that treat people and cultures as abstract concepts. They are composed of a series of technical interventions that are supposed to be universally applicable. The alternative is to be much more sensitive to local and social and cultural practice, that is producing local models of economic activity. In other words, 'the remaking of development must thus start by examining local constructions, to the extent that they are the life and history of a people, that is, the conditions of and for change' (Escobar 1995).

According to this school of thought, development theory and practice has not paid sufficient attention, if at all, to the cultural dynamics of incorporating local thinking and practice into the global orthodoxy of economic thought. Nor has it attempted to make visible the local constructions that exist side by side with the might of global forces. There is, therefore, no question of proposing grand