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Development Economics: The Winds of Change

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"The slings and arrows of outrageous fortune"
— Hamlet.

Ever since its birth as a new discipline, development economics has experienced the heights of universal acclaim as a pioneer (ready to slay the dragon of poverty single-handed) as well as the depths of a heretic isolation (as an outsider to the realm of mainstream economics). Between these two views a consensus is emerging that there is a role, though a reduced one, for development economics. This role exists because the concern for growth and distribution, though in the very veins of mainstream economics, has been highlighted fully only by development economics. However, it is a somewhat reduced role because a greater recognition of the (marginal) utility of free markets, in place of an overly interventionist state – which requires it to speak the language of neo-classical economics, makes it difficult for it to differentiate its 'products' from those offered by others. There also appears to be a changing perception about the key variable(s) that development economics should focus on: the *ends* of development (i.e., improving the welfare of the people) rather than the *means* of achieving it (i.e., the growth of per capita income); a more comprehensive indicator of development composed of such components as longevity and literacy, rather than just per capita income; human capital rather than just physical capital to account for the positive contribution of education and health to economic growth; the gains from international trade, instead of looking at it as an instrument of exploitation of the 'periphery' by the 'centre'; the central role of total factor productivity in achieving high rates of economic growth; and so on.

But, in my opinion, the new consensus about development economics remains ill-defined. In particular, the recommended preference for the markets may

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be misinterpreted, and the government robbed of its legitimate development role. The new-found faith in "openness" may wither on the vine of OECD protectionism; and the search for human development may prove to be illusory because the ends may come to be emphasised at the expense of the means of economic development. Even worse, the new dispensation is not yet anchored to a clear overarching vision. Thus, there is no coming to terms – not yet – with the essentially paradigmatic character of development economics; with its "mixed" economy vision; and, above all, with its deeply ethical nature. It is, thus, no wonder that the breakdown of the communist regimes in Eastern Europe and the disintegration of the Soviet Union are being widely misinterpreted as offering a lesson to our discipline – that we, too, should see in the political triumph of democracy the victory of the natural laws of growth and development that capitalism enshrines. Never mind if reinstating the markets entails, as in the West, some distributive injustice and a lot of unemployment – it is a price that must be paid by the poor and the deprived in society to ensure economic and political freedom.

In the present address, I shall recount the reasons why it may be more prudent to suspend a final judgement on what development economics (or economists) should be doing and how. A lot of homework remains to be done to make the new consensus convincing.

THE PIONEER'S TEXT AND THE AGNOSTICS

Before I come to my main thesis, let me recapitulate briefly the march of development economics through time.

The Pioneers

As a newcomer in the economics mainland, and looking for an identity of its own, development economics claimed to offer the key to development success. Borrowing heavily from the Harrod-Domar model, it prescribed raising per capita income by achieving a higher level of investment and saving – which, in turn, can be secured by significantly increasing the share of profits in national income [Lewis (1954)]. The development effort should be a "big push" affair to break the "vicious circle" of poverty [Rosenstein-Rodan (1943)]. It should be a "balanced" one to match the structure of supply to the structure of demand, if the supply of key industrial inputs is elastic [Nurkse (1953)]; but it had better be "unbalanced" if the supply of investment resources is assumed to be inelastic [Hirschman (1958)]. Driven by the engine of growth (i.e., industry), a developing economy may encounter the inevitable domestic resource gap, but that would be filled by a reasonably elastic supply of foreign aid in order to prepare it for the Rostowian "take-off" [Chenery and Strout (1966)]. In this development odyssey, which in all

probability would end gloriously, the developing countries will be guided by the European example to explore the virgin lands in the Third World [Gerschenkron (1952)]. Of course, "export pessimism" would be a nagging reality for a periphery trying to escape from the gravitational pull of an exploitative centre [Prebisch (1950)], and from the "backwash effects" of international trade [Myrdal (1956)]; so import-substituting industrialisation may have to be practiced, at least in the initial stages of economic development.

In this success scenario sketched by the pioneers, one *can* discern a deep *etatistic* colouring and a certain distrust of the free markets. This, because in view of the widespread technical externalities the state must intervene to repair manifest market failures and maximise social output and welfare [Scitovsky (1954)]. The state must also mobilise large amounts of investment resources to *initiate* the development effort, especially when it requires the establishment of heavy-industries [Mahalanobis (1953)]; and because, in the modern-day parlance, not enough markets exist. Yet, it needs to be clearly understood that the pioneer's vision of the economic universe was that of a "mixed economy", explicitly allowing for the private ownership of the means of production and recognising the institution of private property – a very un-Marxian position to take, notwithstanding their Marxian resolve not only to understand the reality in the poor countries, but also to change it for the better. The development paradigm was *not* communistic, in that it did not regard the passage of real and financial resources from the private to public hands as an absolute good.

One important aspect of the pioneer's version is its remarkable insensitivity to the problems of distributive justice. This was partly due to the belief that since the wage-earner's propensity to save is nearly zero, and that of the capitalist's close to unity, the growth equilibrium would be determined exclusively by the savings rate of the capitalist [Kaldor (1955)]. Then, according to Lewis's two-sector model, the process of structural transformation depends crucially on a perfectly elastic supply of labour – which guarantees that labour is supplied to the capitalist sector at a *constant* real wage. This fact also guarantees that the capitalist profits will be continuously raised as economic (read, industrial) growth accelerates. Thus, income inequality will keep on widening with economic development; it can begin to narrow only when the "turning point" is reached – i.e., once all surplus labour has migrated to the urban areas and the urban wage has started to rise [Fei and Ranis (1963)]. But reducing inequality will be the more difficult the less egalitarian is the initial distribution of assets [Adelman and Morris (1973)]. An air of fatalism is added to the pioneer's vision by the somewhat deterministic shape of Kuznet's *'U'* curve (1955). In a similar vein is Kalecki's view (1971) – with the difference that here the de-equalising consequences of growth emanate mainly from the mode of financing economic development.

The Agnostics

As opposed to the somewhat optimistic mood of the pioneers, there are those who regard Walrasian neo-classical economics, blessed with the beneficence of self-clearing competitive markets and armed with the alchemic rules of Pareto-optimality, as relevant to the developing countries as it is to the developed countries [Schultz (1981); Haberler (1988)]. They share the pioneer's development optimism, but discredit development economics as the proper discipline to understand, let alone solve, the problems of economic development. Indeed, it has been declared as a deviant from the mainstream and responsible for the poverty of the poor countries [Walters (1989)]; *because* of its propagation of a heretical *etatistic* gospel, instead of singing praises of the first-best free markets, which suffice to accomplish the task of economic growth – perceived as mainly a matter of finding *efficient* market solutions [Bauer (1972)]. Development economics is also condemned, because of its perception of a 'closed economy', which regards all domestically produced goods as non-tradeable, thus securing the economy from the magic touch of the first-best international prices [Bell (1987)]. Instead, the key to the economics of growth is to regard trade as a "vent for surplus" [Myint (1964)]; and to promote export expansion [Little (1982)].

The anti-*etatistic* stance of the agnostics has been helped by the 'findings' that government intervention typically entails the diversion of immense real resources to wasteful activities, like "rent-seeking" [Krueger (1974)] and "directly unproductive profit-seeking" (DUP) [Bhagwati (1982)]; and also because the state-directed industrialisation tends to impose heavy losses on the developing countries via the high and variable effective rates of protection [Little, Scitovsky and Scott (1970); Balassa (1971)]. Thus a sure-fire prescription is to watch the first-best (or the second-best) constellation of product and factor prices, steering clear of state intervention.

Significantly absent from this account of the development process is the balanced growth doctrine because international trading opportunities at parametric prices offer perfectly elastic demand schedules as opposed to the inelastic demand schedules assumed by the doctrine. [Bell (1987)]. Also, there is no mention in the agnostic's account of economic development of such problems as unemployment and distributive justice because, in a regime of flexible factor prices that neo-classical economics postulates, involuntary unemployment cannot exist [Friedman (1968)]. Also, perfectly competitive markets provide solutions which are not only efficient but also just; for, in a regime of competitive efficiency, once the set of (shadow) prices equals their marginal product and Euler's Theorem ensures that this equality always holds, it is not possible to have an unjust distribution of income [Stigler (1981)]. Based on Pareto-optimality, such solutions are *unanimously*

accepted, so that such a state of the economy, once attained, need not be improved upon [Buchanan (1986)]. To secure distributive justice, the only neo-classical route out of the Paretian labyrinth is to choose another point on the contract curve by redistributing the initial endowments; but, alas, all that one is permitted to do in order to get justice is to make lump-sum transfers from the gainers to the losers – transfers that, in fact, are not made at all!

THE EMERGENCE OF THE LATECOMER'S TEXT

Partly responding to the agnostic's attack, and partly learning from (the essentially neo-classical rendering of) the development experience – especially of the incredible East Asian countries, the pioneer's development text is being revised by the 'latecomers'. It is these revisions that provide the foundations of the proposed new consensus – i.e., that development economics should be "market-friendly"; that it should be more open; and that the conceptual foundations of the discipline need strengthening to make it more equitable and humane.

(i) A "Market-Friendly" Development Economics

According to a fairly representative evaluation of the new trends in development economics, "a consensus is forming in favour of a 'market-friendly' approach to development in which governments support – but do not supplant – competitive markets". Market-friendliness is unambiguously welfare-raising because "competitive markets are the best way civilisation has found for efficiently organising the production and distribution of goods and services". [*World Development Report* (*WDR*) (1991), *Summary*, p. 1]. There are a few things about this "market-friendliness" that should be noted. First, in contrast to the anarchism of the neo-classicists (of the Walrasian vintage), it does *not* recommend discrediting the government altogether. Instead, the latter must do the job of "of investing in education, health, nutrition, family planning, and poverty alleviation; building social, physical, administrative, regulatory, and legal infrastructure of better quality; mobilising the resources to finance public expenditure; and providing a stable macro-economic foundation, without which little can be achieved" (p. 9). In addition, the governments must establish an "educational base which is essential for developing technological capability; promote competition, coordinate efforts for quality control; and protect intellectual property rights" (p. 88). This is a tall order, requiring the state to provide an enabling environment in which the markets can work competitively. It is definitely not a prescription for a Nozick-like potion that makes the government become smaller and smaller, as if an Alice in her *wonderland.*

Second, market-friendliness is *not* necessarily the antidote of *total govern-*

ment failure, nor does it reflect a faith in complete market success. It is explicitly recognised that "if markets fail and the governments intervene cautiously and judiciously in response, there is a further gain" (p. 2). Third, a return to the market should not mean leaving distributional issues to the market, even though it is emphasised that many inequities may have been created by injudicious state intervention itself. Thus, structural changes – involving a redistribution of assets, land reforms, and the creation of safety nets for the poor – are consistent with a market-friendly strategy of economic development.

The *World Development Report 1991,* thus, seeks to build bridges between the unqualified *government* animosity of the agnostics and the *etatistic* proclivities of the early development economists. While it unambiguously believes that "... all too often, the combination of pervasive distortions and predatory states leads to development disasters" (p. 10), it shies away from the nihilism of the rational-expectationists who condemn macro-economic management as a useless exercise because the egotistic economic agents adjust instantaneously to government intervention [Lucas (1972)]. But, somewhat inconsistently, market friendliness draws support from the thesis that government intervention, *as a rule,* panders to the vested interests in the society [Becker (1983)]; and that it imposes a heavy economic cost on the economy by way of "rent-seeking" and the DUP activities. This is inconsistent, because the *WDR 1991,* does *not* seek to abolish, or even minimise, the government; instead, it is entrusted with the big job of safeguarding not only the interests of the society but also those of the private sector.

(ii) An "Open" Development Economics

Another aspect of the bonds of market-friendliness is the resolve to be "open", – i.e., to permit a "free flow of goods, capital, people and knowledge". [*WDR* (1991), p. 88]. The emphasis here is not only on the free flow of goods and services to restore the equality between the marginal rates of foreign and domestic transformation (and the rate of domestic substitution); but, even more fundamentally, it is on a greater openness to technology, which reduces the cost of production and expands the variety of goods produced in the country. And this happens both through the "supply-side channels" – i.e., by being able to import capital goods, which embody new technology – and by the demand-side pressures of having to produce at competitive prices by adopting the least-cost technology. Now this is a decided gain because such a technology will be typically labour-intensive, as opposed to the capital-intensive technology that a protective regime tends to favour. Openness also tends to favour greater direct foreign investment, which is regarded as definitely helpful because foreign aid is becoming less reliable as well as getting smaller in size.

As noted above, the pioneer's vision of development economics was of a closed economy – or one nearly closed by export pessimism and elasticity pessimism, as predicted by Prebisch (1950, 1984) and Nurkse (1953). The former suggested that the terms of trade moved secularly against the primary products (and the primary producers), irrespective of the kind of domestic policies adopted. The evidence about the terms of trade is, however, quite mixed [Spraos (1980)]; and subsequent events have belied to some extent the export pessimism of the pioneers during the 1960s. The exports from the developing countries grew twice as fast as the industrial countries' income; and even during the sluggish 1970s, the developing countries' exports of manufactured goods expanded four times faster than the GNPs of the industrial countries [Bhagwati (1988)]. Now such evidence may be interpreted as a denial of the pioneers' view insofar as all the successful developers have become significant exporters of manufactured goods, not just of primary goods. But the terms of trade have, in fact, moved secularly against the primary products – though by only 0.3 percent a year during the 1920–86 period [*WDR* (1991), p. 106]; and such products continue to provide a significant proportion of the developing countries' exchange earnings.

An important aspect of openness is that it seeks to impose a market discipline on the domestic producers, who may then have to adjust to a parametrically given world price. The disciplining effect works through the linkage between world prices, tradeable goods, and the non-tradeable goods. A standard result is that, in the case of a "small economy", the domestic relative scarcities of the tradeable goods correspond to world prices; and the same holds for the non-tradeables, which are used alongwith labour to produce the tradeables [Diamond and Mirrlees (1971)]. Thus "open" developing economies, even when practicing state intervention in the domestic market, are "saved" from their follies by market discipline [Little (1982); Krueger (1978)]. This conclusion is supported by the example of the East Asians, who managed to grow fast even with considerable protection.

(iii) A "Humane" Development Economics

Another influential element in the new consensus is the recognition that "the relation between GNP and living conditions is far from simple" [Sen (1988), p. 13]. The success of the development process is not to be judged by maximising the flow of commodities but by seeing this flow as a means of achieving a functioning – i.e., what people *do* with commodities, and what types of *beings* they achieve with them. These *beings* include, among other things, living a long and healthy life, being educated, and so on. In other words, economic *development* needs to be seen "in terms of ends rather than means". In general, it is a matter to be free to make alternative choices between various options that the development process continuously offers. Thus, economic development should be seen as a matter of "entitlements" and "functionings", instead of "commodities" and their "characteristics".

This approach is being 'operationalised' in the UNDP's *Human Development Report (HDR),* which recommends focussing *directly* on human development instead of waiting for economic growth to do it because "the expansion of output and wealth is only a means", and because "there is no automatic link between income growth and human progress" [*HDR* (1990), p. 10]. Hence the shift of emphasis of public policy from the growth of income *per se* to human development: "development has to be woven around people, not people around development" (p. 13); and it should enlarge people's "development choices" and their "capabilities". Thus, to measure economic development in this sense, what needs to be maximised is *not* per capita GDP but a Human Development Indicator (HDI), which is essentially an unweighted average of adult literacy, life expectancy, and income – unweighted, because all three variables are accorded equal weights. The index itself is constructed by reference to a set of *maximum* and *minimum* values attained by *any* country with respect to each of these variables – to be exact, it is 78 years for life expectancy, 100 percent for literacy, and (a logarithm of) the average poverty-line income of a typical *developed* country. *HDR* (1991) retains these very variables but makes certain adjustments of a technical nature with respect to the literacy and the income variables. To evaluate the state of (human) development, the technique is to focus attention on "shortfalls" ("deprivations") rather than "attainments" with respect to these variables as a reminder of what still remains to be achieved. The UNDP's research programme consists mainly of making the HDI more inclusive, especially by linking it up with an appropriate Human Freedom Index (HFI). This is on the belief that "people do not isolate the different aspects of their lives. Instead, they have an overall sense of well-being." [*HDR* (1990)].

(iv) An "Equitable" Development Economics

An implication of the recommendation to make development economics humane is that it should be equitable. Thus, *HDR 1991* explicitly lays down: "the growth issue should be one of quality rather than quantity, one of more equitable distribution rather than mere expansion" (p. 13). The *WDR 1991* strongly recommends "investing in people", which aims to increase people's welfare directly and not leave it to the market. These suggestions make eminent sense because actual experience with the development process in a large number of countries shows that the fastest growing (non-oil producing) countries – e.g., South Korea, Japan, Singapore, etc. – are also the ones where the investments in human capital (education, health etc.) have been very high; and they are also more equal than the slower growing ones. In these countries, partly because of such investments, total factor productivity is high. The last-mentioned 'fact' suggests that the trickle-down effects of economic growth – a higher rate employment-generation coupled with a steady rise in the real wages of the unskilled labour – tend to be stronger when the 'best',

(or the least-cost technology is used, and when a higher level of education and health has raised the quality of labour and the efficiency of input use.

TOWARDS A REVISED DEVELOPMENT TEXT

I shall now comment briefly on each of these matters.

(i) "Market-Friendliness" or an Ideological Infatuation

The market *versus* the government debate has been conducted at two distinct levels, each of which should be carefully noted in the interest of clear thinking. First, there is the all-out advocacy of free and competitive markets, which are assumed to work with text-book accuracy – also in the *real* world, including the developing countries. Given that *market* prices equal the *shadow* prices both in the product market and the factor market, and that all the markets exist, the prices perform an inexpensive informational role in organising consumption, production, and distribution efficiently. Once this is granted, government intervention can *only* spoil the utility-profit maximisation show [Schultz (1981); Bauer (1972); Haberler (1988)]. Second, even though the market fails in the face of externalities, yet government intervention does not necessarily follow from this, because the governments also can, and do fail – and this failure is typically more costly than market failure [*WDR* (1991), pp. 129–33]. Furthermore, governments do not typically seek to maximise some social welfare function; instead, they respond to lobbying by vested interests. Even worse, they are also, as a rule, corrupt [Krueger (1974); Bhagwati (1982); Brock and Magee (1984)].

Both these arguments stem from the belief that if only the government abstains from interfering in the factor and product markets, the first rules of competitive efficiency will 'again' come into play – 'again', because these rules are assumed to rule the roost in the state of bliss, which is made inaccessible by sinful government intervention. But buying a one-way ticket to this text-book primordial state (of nature) – distinguished by the equality of the marginal rates of substitution in consumption with the marginal rates of (domestic and foreign) transformation in production may not be a rewarding experience because 'market success' is guaranteed only *if* there are "enough" markets; *if* both the consumers and the producers behave competitively; and *if* equilibrium exists. A non-satisfaction of *any* of these conditions amounts to a withdrawal of the guarantee of market success [Debreu (1959)]. Fragile, indeed, is the basis of market success. Thus "a pure market system with its high degree of decentralisation runs the risk of bringing inequitable results and being inefficient because markets can never be complete, because externalities exist, and because the public wants tend to be neglected." [Malinvaud (1989)]. It also follows that *if* (buyers' or producers') monopolies exist, or *if* relevant markets

do not exist, *then* market failure is unambiguous, and that this failure can be effectively repaired by *direct* government intervention. It can be said that the replacement of a public monopoly by a private monopoly offers no guarantee of market success just because goods and services produced by the public sector before are now provided by the private sector. The danger is that in our bid to win the friendliness of competitive markets we may as well end up in the bear-hug of a private monopolist.

Then, what should be done? The standard result is to invite the government to break the hold of monopolies by enforcing trust-busting regulation. But is there a way of avoiding the rent-seeking, DUP ridden, and corrupt government – which is prone to fail even more than the market? Perhaps. Things may improve if, for instance, the state, by satisfying the "perfect market contestability" conditions, effectively prevents the private producers from excessive profits and predatory and cross-subsidy pricing practices [Baumol and Lee (1991)]. Then, theoretically, enough markets can be created – e.g., future markets can be established to signal to the present producers about the future demand for their goods; and contingent markets may repair the market failures caused by informational deficiencies about the true state of the world. The "local" public goods, which can be consumed only selectively by the residents of a certain area, can be consumed by an individual to the exclusion of the non-residents by moving to that locality [Tiebout (1956)]. Also, public goods can be allocated *through the markets* by the introduction of Lindahl prices, *provided that* the consumers behave competitively [Foley(1970)].

But all such strategies, though possible, may not be feasible. For instance, "free riding" may prevent the individual consumers and producers from acting competitively [Arrow (1969)]. This also takes care of the Coase Theorem (1960), which asserts that externalities are self-correcting. Then, while government may be wasteful when patronising rent-seeking and DUP activities, *the same is the case with the free markets* when an "agent" commits "fraud" (in a strictly technical sense) against the "principal": real resources in this case are diverted to the "provision of unnecessary services" [Karni (1989), p. 118]. On a more general plane, in a typical developing country, regulating monopolistic behaviour through public legislation may be more difficult than undertaking production (say, of a wage good consumed by the poor) by the state itself. It follows from these considerations that even though market failure does not *always* imply state intervention on a logical plane, yet the difficulty of making consumers and producers act competitively may dictate direct state intervention – perhaps, as a second- or third-best alternative!

Another point that needs to be noted is that to fructify market-friendliness, market prices are *assumed* to equal shadow prices in the product and factor markets. The presumption is that, once the government-induced distortions are removed, market prices will approximate shadow prices because of the disciplining

effect of the 'undistorted' world prices. But this may or may not happen. It will happen only if there are no distortions in the labour market and if the savings are optimal [Diamond and Mirrlees (1971)]. Now these conditions are generally violated in a typical developing country; though without satisfying them, the disciplining role of the world prices on the domestically produced tradeables and non-tradeables will evaporate in thin air!

(ii) The Question of "Openness"

The rule of free markets is also equated with a situation marked by unrestrained export expansion – *even* when positive export subsidies are given [Krueger (1978)]. By contrast, import substitution is equated with government intervention – and with development economics. The East Asian countries' unprecedented growth performance is then seen as vindicating the honour of the markets. Now, obviously, no economist would deny that, within certain limits, foreign trade is welfare-improving. However, there is an important aspect of this "openness", where the evidence is not so persuasive. And this relates to the export-orientation vs the import-substitution debate – and to the conclusion that the fastest growers, especially South Korea, have also been the most export-oriented [Little (1982); Krueger (1978)].

Many observers have noted, on the other hand, that the seeming export bias of countries like Japan and South Korea is in fact another name for the practice of dumping through market segmentation – examples more of mercantilism than of trade liberalism [Findlay (1988)], and that a heavy import substitution episode preceded, even supported, the export promotion efforts of these countries [Pack and Westphal (1986); Pack (1988)]. The fact is that, the key to the South Korean growth success is not the pursuit of inward- or outward-looking policies (both were pursued singly and together); it is rather their ability to use the relevant policy instruments "with speed and flexibility, tackling economic targets like a military operation" [Bardhan (1988), p. 62]. At any rate, the export-promotion (EP) strategy, which is essentially *incentive-related,* need not necessarily have contributed to the episodes of income growth or export expansion [Bhagwati (1988)]; indeed, the reported one-way causal link between export growth and income growth might have been mistaken for the opposite chain of causation from output growth to export expansion! Furthermore, contrary to the earlier claims, there is not much systematic relation between the structure of EP strategy and the import substitution (IP) strategies (and the associated measures of protection, like the EPR and the DRCs) and the pattern of resource allocation [Bhagwati and Srinivasan (1979)].

That being the state of the art, there appears to be some merit in the "unequal exchange" conjecture, the centre-periphery syndrome, and the elasticity pessimism hypotheses [Singer (1950); Emmanuel (1972); Amin (1973)], even though these

arguments may have been taken too far in support of an overly protectionist posture in *some* developing countries. While the East Asians have succeeded in expanding their exports, their success, it can be argued, may have been due to the multinationals producing primarily for the export markets. But a lot of other developing countries, mainly the South Asian and African countries, have experienced great difficulties with their exports. Thus, even though appropriate domestic (EP) policies have been helpful for export-expansion, there are definite limits on what developing countries as a whole – if not the individual (small) countries – can do to become more and more open *irrespective* of the trading policies of the industrialised countries. True, as noted by Bhagwati (1988), developing countries' exports to developed countries did increase during the 1970s even as the OECD countries were busy raising non-tariff barriers (NTBs) such as voluntary export restraints (VER); yet, this does not mean giving the OECD countries a free hand to practice protectionism while preaching free trade to the developing countries.

The fact is that rising OECD protectionism has been very costly to the developing countries: it did cost to the latter as much as $55 billion in a single year (1980) in foregone exports (Laird and Yeats (1987)]! The size of this loss must have increased significantly since then because the incidence and intensity of OECD protectionism has continuously increased during the 1980s – so much so that "the share of trade covered by non-tariff barriers in industrial countries could be equal to 28 percent of the trade covered by all non-tariff measures in developing countries in 1987." [*WDR* (1991), p.105.] As if to add insult to injury, the net resource inflow from the developed countries has become negative. All these factors have deepened the debt crisis in the developing countries.

Thus, openness, even though a virtue, is not without its limits; and there may be some truth in the dependency hypothesis that, at least to some extent, the true dynamics of capitalist development lies outside the 'peripheral' economies [Cardoso and Faletto (1974)]. In the third-best, even the *n*th best, world of reality one will have to devise mixed strategies. While, on the one hand, every effort should be made to mitigate unnecessary market-distorting domestic policies; yet, on the other hand, a concerted action should be taken to offset the de-equalising tendencies of the OECD protectionism. There is a great force in the demand for a NIEO, which seeks to establish world trade equations on a more *equitable* basis – which seeks, specifically, to stabilise the developing countries' export *earnings*; to find some kind of a stabilisation fund (in the form of Common Fund (CF) or the STABEX); to reduce the rising debt liability of the developing countries; and to demand preferential access to the developed countries' markets without the commitment to grant reciprocal privileges to them. Above all, the Uruguay Round talks must succeed to roll back the rising tide of Western protectionism.

(iii) What Maximand to Maximise?

I noted above the pioneering efforts by Sen (1988) and the UNDP to find a new maximand in order to enhance the social well-being content of the development effort. An important spin-off of this line of research is to bring development economics and social choice theory together; it is also to accept the legitimacy, indeed urgency, of ethical considerations for the development economics calculus. Both these insights are substantial. The social choice perspective opens up a window for development economics to consider a whole galaxy of decision rules, instead of pushing the Pareto-optimality rule along extensive and intensive margins – which activity can yield only sharply diminishing returns in the realm of our knowledge about the developing countries. Also, on a practical plane, thanks to the UNDP's efforts, many developing countries may be helped to overcome unnecessary inhibitions against spending on human development.

But there are serious problems with such a perception when it is made *the* conceptual basis of development economics. This is partly because the new research programme – focussing on expanding entitlements of the poor [Sen (1983)], on their "functionings" [Sen (1988)], and more generally on the "ends" rather than the "means" of development – rests on a very limited number of cross-country observations. Sen (1983, 1988) notes that in five countries – China, Sri Lanka, Brazil, Mexico, South Africa – a higher per capita income is associated with lower life expectancy at birth. But this is not enough evidence to conclude that: "not merely is it the case that economic growth is means rather than an end, it is also a case that for some important ends it is not a very efficient means either". Now, this is not enough evidence to unseat per capita GNP as a maximand and start the search for a new conceptual foundation of development economics. For the selection of the "problem countries" has not been made on a random basis; so that Sen's conclusion does *not* hold for *any* group of countries. Indeed, in general, on the basis of the wealth of data presented in the two UNDP reports published so far, one arrives at the *general* conclusion that the countries with higher levels of income also enjoy higher longevity: the correlation coefficient between the GDP (in purchasing power dollars) and the life expectancy at birth is 0.70 – which is enough to refute Sen's casual empiricism.

There is another limitation to Sen's perception which should be noted. His characterisation of the development process "in terms of expansion of entitlements" [Sen (1983)] has been inspired by his pioneering study of famines. In that context, he reaches the conclusion that the incidence of famines – which is defined as a total breakdown of the entitlements of the poor – is independent of the *availability* of foodgrains [Sen (1981)]. But this remarkable result can hardly be generalised to a systematic consideration of the problems of economic development. Unless one were to assert that all developing countries are caught up in a big famine, it would

be very artificial to assert that the availability of goods and services do not matter to achieve development success!

The same criticism also applies to the UNDP's research programme of searching for a new maximand (HDI) *in place of* per capita GNP. This research programme, based on Sen's approach to development economics, also starts with a limited cross-country comparison of six countries – Sri Lanka, Jamaica, Costa Rica, Brazil, Oman, Saudi Arabia – to conclude that the aim of economic development is human development *rather than* raising per capita GNP. But is it so? Even a back-of-the-envelope calculation is sufficient to refute this assertion *if* it is presented as a general rule. Thus, the correlation coefficient between the HDI (the UNDP's Human Development Indicator) and the GDP is 0.76; and the same is true if the GDP is paired with literacy, longevity, or infant mortality. Even more to the point, if the HDI is regressed on the adjusted GDP (in purchasing power parity – PPP – dollars), the latter explains 68 percent of the variation in the former; and the coefficient is highly significant with a *t*-value of 15. Thus, even if the other components of the HDI – longevity and literacy – are also important, the per capita income variable dominates it. Which is another way of saying that one may persist with raising per capita GNP, with due attention paid to education and health, and then confidently hope for the best in term of human development as well. At least here is a case where the pioneers turn out to be more perceptive than the latecomers!

Another point concerns the *HDR*'s claim, which is true, that there is no *automatic* one-way causal link between per capita GNP growth and human development. But, then, what basis is there for assuming (indeed, asserting) that there is such an automatic causal link between human development and economic growth? Indeed, there is no guarantee that additional expenditures on education and health will *always* raise per capita incomes, for, "investing in education buys no guarantee of faster growth. When economies are badly managed, investment in people may go to waste" (p. 53) [*WDR* (1991), p. 53]. Such investments will also go waste if, because of macro-economic mismanagement, the growth of per capita income slows down and, as a result, the unemployment rises.

The point I wish to emphasise is that a clear recognition of the *ends* of economic development need *not* detract us from the widespread agreement in development analysis about the *means* of achieving these ends. The importance of this observation can be highlighted by comparing the Malaysian and Sri Lankan experiences with economic growth *and* human development. According to *WDR* 1991, both these countries had the same per capita income in 1960; but during 1960–87, Malaysia grew at 7.0 percent and Sri Lanka at 4.4 percent; total factor productivity was about 1.5 percent in Malaysia and 0 percent in Sri Lanka. Even more important, (during 1960–88) infant mortality fell to 15 in Malaysia, and to about 30 in Sri Lanka; and the share of the poor dropped to 15 percent in Malaysia,

and to 27 percent in Sri Lanka. The reason? The *WDR* 1991, in a rush of market-friendliness, attributes these differences only to the greater openness of Malaysia. That may be so; but, I think, that an equally plausible reason is that Malaysia went ahead with its high-growth strategy, while Sri Lanka was more preoccupied with the so-called human development rather than growth. This example is apt because Sen, and the UNDP, present Sri Lanka as an exemplary case where greater human development was achieved directly even with a low per capita income!

Thus, contrary to Sen's (and the UNDP's) assertions, the proper lesson to draw from the Sri Lankan experience is that, in the pursuit of ends, one *should not* forget the means – i.e., raising the per capita GNP. The East Asians (and also the Chinese) have shown that modern technological advances have made it possible for them to double the per capita income in less than decade or so – something that the Americans and the British achieved in more than half a century or so. Such high growth rates, when maintained for long periods and helped by the wonders of a compound interest, transform people's income *and* everything else that matters for achieving a "better living" – literacy, longevity, and distributive justice. True, this requires proceeding on a wider waterfront to capture the most potent linkages between human development and economic growth, but the pioneers recommendation to raise per capita incomes as a key to economic progress, duly amended to include greater expenditure on education and health, should continue to be the cornerstone of a sound development policy – indeed, as yet another illustration of the universal truth that old wine is better than a new bottle.

(iv) Towards a "Just" Development Economics

The greater accent on the importance of distributional issues, in the new consensus that I discussed above, is definitely a step in the right direction. A World Bank study of thirty-two countries shows that "there is no evidence to suggest that higher saving is positively related to income inequality or that income inequality leads to higher growth. If anything, it seems that inequality is associated with slower growth." [*WDR* (1991), p. 137]. Pack (1988) also finds that industrial growth in the LDCs has been fairly equitable.

This evidence may seem to be at variance with the widespread empirical support of Kuznet's *U* conjecture [Ahluwalia, Carter and Chenery (1979); Ahluwalia (1976)]. But many studies [Adelman and Morris (1973); Papanek and Kyn (1986) suggest that the relationship could be either *U*-shaped (as inevitable), or that it is *J*-shaped (as policy-induced). Thus, insofar as such inequalities are policy-induced, and a higher investment in human capital – particularly that raising factor productivity – can be income-equalising, the two pieces of evidence may not be entirely contradictory. Furthermore, there is strong evidence to suggest that an alle-

viation of absolute poverty may also be inequality-reducing if the middle-class does not lose ground in the process [Adelman and Robinson (1989)]. Thus, it stands to reason that absolute poverty in the fast-growing countries has also been reduced by the achievement of universal literacy (focussing on *primary* education), and by direct income transfers in the form of social security payments, etc. Other factors contributing to the same result may have been a more equitable distribution of assets holdings at the initial stage through sweeping land reforms – as, especially, in Japan, South Korea, and China.

I shall make only two additional comments in this context. Firstly, while the distributional problem is properly seen as amenable to 'direct' solutions (i.e., greater expenditure on the provision of social services), the importance of the trickle-down effect of growth through a rising real wage and greater employment generation has been unduly de-emphasised in the new consensus. Also, securing distributive justice is as much a matter of investing in people as of what these people do once such investments are made in them – mainly by contributing to the development of a more efficient (labour-intensive) technology. Secondly, the distributive issues are basically ethical, and cannot be fully comprehended by the positivistic calculus that *both* development economics and neo-classical economics have (incorrectly) endorsed. This is because the values pursued by a society in the context of development are not only *instruments* but also *ends* in themselves – and a choice between them can be made meaningfully on an ethical basis only. Indeed, "the foundational role of values can be neglected in favour of an instrumental view only by trivialising the basis of the concept of development" [Sen (1988), p. 23]. At a theoretical level, a recognition of the ethical values means that our insistence on strict positivism is sufficiently relaxed if not completely abandoned. Instead of anchoring development economics to Pareto-optimality, we should also include in our repertoire other morally non-neutral social choice rules – e.g., the Harsanyi's equiprobability model (1977), Hare's principle of universalisability (1963), and the Rawlsian conception of "justice-as-fairness" (1971).

THE EPILOGUE

What I have presented in this address is a brief chronicle of the "happenings" in the general area of development economics. Many of the new insights into the development process are indeed crucial – e.g., that both the market and the government should be used, with the former mainly entrusted with the task of producing goods and services; that economic growth and distributive justice are essentially complementary; that one need to go beyond physical capital accumulation and saving to the process of human capital formation and technological change in order to explain the growth process and accelerate its rate; that while thinking about the means of economic development, we should relate them to the *ends* of this process.

In gaining such insights, by and large, development economics has moved in the right direction. Yet, for all these insights, our discipline remains far from attaining its 'steady-state'. And, both from the theoretical and the practical points of view, a proper attitude is one of healthy scepticism with respect to the new consensus. Thus, "openness", a mixed blessing, can be taken too far – forgetting that the centre-periphery scenario, with a dash of export pessimism, may have some truth in it. Then, "market-friendliness" can become much too intimate, indeed an ideological infatuation; and, in the process, we may forget that social welfare cannot be maximised by free markets alone, nor can structural change be entrusted to them entirely. And the important philosophical debate between the *means* and the *ends* of growth can prove to be counter-productive if, at the policy-making level, the latter is emphasised at the expense of the former.

I conclude by making four observations:

First, it is important that we remember the *development* role of the state, even as the markets are bolstered to take on the responsibility of producing goods and services on a more efficient basis. It is one of the great insights of development economics (according to the pioneers' text) that market success is not guaranteed, and that state intervention becomes legitimate, even essential, when the development process is to be initiated, when public goods must be provided, when externalities of diverse kinds obtain in the situation – indeed, in all those cases where *social* welfare diverges from *private* welfare. This insight, signifying the mixed-economy vision of development economics must be preserved. There is not much merit in the argument that even when market fails manifestly, such failures are best treated through the markets because the government would do even worse. The fact is that in cases where such failure is of a fundamental nature, there is no alternative but to "accept self-interested behaviour and explore non-market alternatives" [Ledyard (1989), p. 184]. In fact, all depends on whether, in the event of decentralisation of economic decisions, the individual players play their game according to the rules; and what is done if they do not conform to the prescribed behaviour. This is a serious problem because "once the rules of organisation and decisions are known, individual agents may benefit from misreporting their private information..." [Malinvaud (1989)].

Thus, in emphasising the autonomy of the individual (producer, consumer) both as an absolute and as an instrumental value, we must not lose sight of cases where individual greed overtakes social responsibility – in technical parlance, where the "moral hazard" problem is too pressing to be treated by free markets alone. In all such cases, the society must be protected from the individual, and the individual saved from himself. As we applaud the expanding role of the markets, it should not be forgotten that this exercise is not done just on ideological grounds to guard the (rich) individual's liberty. And if the production of goods and services

must be entrusted to the private sector, it should not be in the spirit of atoning for the past sins of the public sector but to organise production more efficiently, and more equitably. At least, here is a case where *ends* are more important than the *means*.

Secondly, a central lesson of the development experience in the last forty years is that "we have moved from believing that climate, culture, and natural resources dictate the pace of development to knowing that trade, markets, and entrepreneurship are crucial determinants of progress" [*WDR* (1991), *Summary*, p. 4]. This way of thinking very effectively destroys the deterministic (even imperialistic) view that economic development is the monopoly of certain people and races, that it is confined to certain regions. It also underscores the central importance of appropriate *domestic policies* in ensuring development success, where the fault lies in ourselves and not in our stars. Thus, a series of steps should be taken by the developing countries themselves to remove the domestic constraints on growth and strengthen the forces of technical change. The developing countries should also undertake profound changes in the basic structures of the society – especially those relating to their feudalistic structures, which distort both the politics and the economics of these countries. All such steps have one thing in common: it is to become receptive to new ideas and be able to respond to new challenges constructively and creatively.

Thirdly, while implementing the new consensus about what development economics is, it must be clearly understood that unfettered capitalism does *not* offer a panacea for the ills that the developing countries suffer from. True, the Soviet Union (which has now ceased to exist) and the Eastern European countries have abandoned communism; yet, doing so does *not* mean that the egalitarian part of the Marxian message should be abandoned as well. I believe that there is an essential element of truth in the socialistic ideas that will survive (the politics of) communism, and which needs to be preserved by all societies which prize equity as much as efficiency; a 'truth' which emphasises not only the political human rights but also the economic rights of the poor. The European welfare states had learnt a few abiding truths from Marx to save their societies from the ravages of unrestrained capitalism – and also from a repressive communism! They combined market and state action, and recognised that the institution of private property, when allowed to go beyond certain recognisable limits, can be destructive of social responsibility. The developing countries, which are having to adjust to the fast-changing scenarios in the "centre", must also do the same.

Fourthly, in order to achieve the requisite clarity of thought and action, the ethical nature of development economics must be *explicitly* recognised. Basically, it means an extension of the narrow positivistic concept of rationality – that is, to go beyond self-interest maximisation as the only mover of the economic universe. If

ethical considerations do influence man's day-to-day behaviour, then it does not make sense to insist on what Frank Knight deplored – "the irrational passion for dispassionate rationality". Indeed, it should matter for the development economist to know as to how human happiness comes about, what the sources of a given state of happiness are, and how that happiness is shared, whether grabbed by a few or distributed more widely. Indeed, when experiencing the exhilaration that comes with the rising sun of economic progress, it is important that we care for the withered lives of the countless millions, so that they too can behold the sky spangled with the stars of hope. And while writing the history of the future that man's economic development is, the accounts of want, poverty, unemployment, and human degradation must feature prominently in it. If cold positivism does not help recognise these problems as vital, then let a warm-hearted ethics lead the way – to understand that *every* individual's welfare matters.

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