The Evolution of Development Thought: An Economist’s Overview

(Based on Gerald M. Meier, “The Old Generation of Development Economists and the New,” in Frontiers of Development Economics: The Future in Perspective)

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The Evolution of Development Models/Approaches

After WWII, Bretton Woods System

First Generation Part I (1950 – mid-1960s)

Development Economics Rediscovered (or Newly Founded)

Grand (Visionary) Models of Development Strategy

- Structural Transformation & Development Planning (National Development Plans)
- Pervasive Market Failures → Extensive Government Involvement (Structuralist, Welfare Economists)
  Lack of a reliable market price system.
  Government-led structural transformation to break Nurkse’s “vicious circle of poverty”,
  and to accomplish Rostow’s “takeoff”.
- Per Capita Real Income → GDP → Capital Requirement (Capital Fundamentalism)
  Harrod(1939)-Domar(1946) model used to estimate capital requirement
- Solow Growth Model/Accounting (1957) → Capital + Exogenous Technology Progress
  \[ Y = F(K, L, t) \]
- Traditional Dualism Models → Two-Sector Model (Lewis, 1954, Fei and Ranis, 1961)
  Farmers in developing countries are poor because they are irrational.
  wages \(\neq\) marginal value product of labor
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WWII First Generation Part II (mid-1960s – mid-1970s)

Grand (Visionary) Models of Development Strategy

- Farmers do respond to economic incentives (found in field studies). They do react to wages and prices. Simplistic Dualism Model does not apply (Shultz, 1964).
  Farmers in developing countries are rational, but poor due to capital scarcity.

- Agricultural Modernization, Human Capital Development
  Physical Capital in Agriculture → Physical Capital + Human Capital
  Development depends on productive human agents.

- Deficiencies in Industrial Programming, Absolute Poor and Inequality Increased (late 1960s and early 1970s)
  neglect of agriculture, inefficient state-owned enterprises, adverse effects of import substitution strategy, BOP deficits

- Government Interventions → Price Distortions (wage rates, interest rates, and foreign exchange rates)
  “Getting Prices Right”, or at least “Avoid Getting Prices Wrong”
  → Resurgence of Neoclassical Economics
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Oil Crises, Collapse of the Bretton Woods System, Debt Crises, Financial Crises, etc.

Second Generation (mid 1970s – the Turn of Century)

- Resurgence of Neoclassical Economics
- From Grand (Visionary) Models of Development Strategy to Technical Application of Economic Principles (Neoclassical)
- From Highly Aggregative Macro Models to Specific Micro Studies such as a change in tariffs or agricultural subsidies (Arrow, 1988)
  → Macro adjustments in accordance with micro incentives.
  → The birth of Development Microeconomics.
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Second Generation (mid 1970s – 1990s)

- Resurgence of Neoclassical Economics
- From Grand (Visionary) Models of Development Strategy to Technical Application of Economic Principles (Neoclassical)

✓ “Get (All) Policies Right”
Abolish price distortions created by government interventions.

✓ Structural Adjustment Policies by IMF and World Bank (from early 1980s on)
A country was not poor because of the vicious circle of poverty but because of poor policies.
Liberalizations and IMF Conditionalities.

✓ Governance (Economic Governance) and Promotion of Policy Reforms (1990s)
For Africa’s failure in structural adjustments and industrialization, and for financial crises (incl. Asian Financial Crisis), the lack of sound economic governance was blamed.
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Second Generation (mid 1970s – 1990s)

- From Highly Aggregative Macro Models to Specific Micro Studies

✓ A closer look at the “Residuals” Total Factor Productivity
  A composite of the effects of many different forces (Harberger, 1983; cf. Meier p. 18).
  The power of ideas and innovations. New Endogenous Growth Theories. (Romer, 1986-)

✓ New Market Failures and the Birth of Development Microeconomics

• From old market failures (lack of competition, public goods, externalities, etc.) to new
  market failures (risks, imperfect and costly information, incomplete markets, transaction costs, etc.).

• → New or renewed analyses of Agriculture and Finance such as the sharecropping
  and microfinance. Financial institutions and markets was neglected by the first generation.

• Farmers in developing countries are rational, but poor because of imperfect information.
Tasks for the New Generation

Turn of Century

➢ Beyond Income Growth: Patterns of Growth (Quality of Growth)

➢ Understanding the Sources of Growth
  (Globalization of Ideas and Human Capital)

➢ The Influence of Institutions ("Getting Institutions Right")

➢ Defining Social Capital
  The internal social and cultural coherence of society, the norms and values that govern interactions among people, and the institutions in which they are embedded. (Collier, 1998; Meier p. 29) "civil social capital" and "government social capital"

➢ Evolution of Financial Institutions

➢ The Implications of Globalization

➢ Complementarity of State and Market

➢ .....
Meier and Stiglitz, Frontiers of Development Economics (R.3)

Figure 1. The Evolution of Development Thought

**GOALS OF DEVELOPMENT**

- Gross domestic product (GDP) → Real per capita GNP → Nonmonetary indicators (Human Development Index) → Mitigation of poverty → Entitlements and capabilities → Freedom → Sustainable development

**MACROECONOMIC GROWTH THEORY**

- Harrod-Domar analysis → Solow sources of growth → "New growth theory"

**CAPITAL ACCUMULATION**

- Physical capital → Human capital → Knowledge capital → Social capital

**STATE AND MARKET**

- Market failures → Nonmarket failures → New market failures → Institutional failures

**GOVERNMENT INTERVENTIONS**

- Programming and planning → Minimalist government → Complementarity of government and market

**POLICY REFORM**

- "Poor because poor" → Poor because poor policies "get prices right" → "Get all policies right" → "Get institutions right"
Contrasting Analysis in Different Policy Situations
(from G. M. Meier, “The Old Generation and the New” Fig. 1, p. 37)

High understanding of the policymaking process

NEOCLASSICAL POLICY SITUATION
- Chosen problems
- Locationless
- Technical analysis possible
- Exceptional market failures
- Instrumental rationality
- Society-centered polity
- Little politicization
- Institutions given or ignored
- Welfare-maximizing policymaking

Incremental policy changes

Large, innovative policy changes

DEVELOPMENT POLICY SITUATION
- Pressing problems
- Country specific and time specific
- Less technical analysis possible
- New market failures
- Constitutive rationality
- State-centered polity
- High politicization
- Institutional change required
- Political-economy policymaking

Next Generation?

Politics + Economics + Culture = New Political Economy?
Revolutions and the Evolution of Economic Systems
(based on Yukio Noguchi, “IT makes small-scale-organization economy advantageous” Nikkei, April 5, 2002)