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Development Economics: From Classical to Critical Analysis

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Introduction

When development economics emerged as a sub-discipline of economics in the 1950s its main concern, like that of most economic theory, was (and largely remains) understanding how the economies of nation-states have grown and expanded (Szentes 2005). This means it has been concerned with looking at the sources and kinds of economic expansion measured via increases in Gross Domestic Product (GDP), the role of different inputs into production (capital, labor and land), the impact of growth in the various sectors of the economy (agriculture, manufacturing and service sectors) and, to a lesser extent, the role of the state. These concerns are at the heart of classical and neoclassical development economics. In contrast, most radical development economics starts from the other side of the coin – how to improve the welfare of the population and the planet although much development economics in the Marxist and neo-Marxist vein ultimately also focuses on national income. Nevertheless, what can be seen here are two fundamentally different approaches to the core issue of what exactly is 'development,' which is what underlies this exploration of the key ideas of classical, neoclassical, neo-Marxist and critical approaches to development economics.

The chapter explores these traditions in a largely chronological manner as this allows connections to be made between theories and practices of development and highlights the manner in which critiques of existing traditions and new ideas have been central to development economics discourse. The chapter commences with a brief introduction to the three mainstream economics traditions that have most influenced development - classicism, neoclassicism and Keynesianism – because an understanding of the key ideas of these traditions is central to understanding the subsequent growth of development economics. It then looks at how these traditions were expressed in development economics the 1950s and 1960s. Neo-Marxist development economics is also explored as it has been a major tradition and influence on the theory and practice of development. In the 1970s, a new strand of neoclassicism – neoliberalism – rose to prominence and became the major influence on contemporary development theory and practice, though by the early 1990s, it too was being challenged. The chapter concludes by returning to the issue of exactly what development is and how this fundamental question frames the subject of development economics.

Introducing Economics Traditions – Classicism, Neoclassicism and Keynesianism

Classical Economics

Adam Smith's *Wealth of Nations* (1776 / 2001) was the original English classical economic text and, as he says on the first page, what he was examining was why some nations became so productive while others did not, that is to say why they developed. Smith essentially sees economic development: "as a process embedded in, and limited by a particular physical, institutional, and social environment. More specifically, Smith conceives of economic development as the filling-up with people and physical capital ('stock') of a spatial container ('country') that encompasses a given endowment of natural resources and is shaped internally and bounded externally by laws and institutions" (Arrighi 2007). Smith and the other classical economists hypothesized that it was the combination of private capital and property, the free operation – or the 'invisible hand' – of the market and human labor that was the source of economic growth. They moved into more controversial territory though, when they then posited that this system was, with few exceptions, the most efficient one for allocating and distributing resources in society and furthermore, that it was a fair system.

One of the most enduring contributions of classical economics is the central place it gives to trade in promoting development. This belief in trade derives from Smith's ideas about the benefits of specialization and resultant trade in those goods bringing 'gains from trade' as well as from David Ricardo's law of comparative advantage. It is important to note at the outset that classical economist's commitment to free trade was not as rigid as that of today's neoclassical or neoliberal economists. They also saw that trade did, and should, occur in the context of some government controls on both the movement of capital.

At any rate, Smith's focus on specialization was that everybody makes things they are best at producing and they trade those for what others are better at producing. International trade is then simply an extension of trade within a nation-state. Ricardo's theory of comparative advantage expands the theory about what it is that countries should be producing and trading. It basically says that countries should specialize in producing goods and services that they have either the greatest advantage, or the least disadvantage, in producing in terms of the relative costs of production. This can involve two situations, first the case of absolute advantage, where two countries are each absolutely better at producing a respective commodity and hence trade. The second and more complex idea is trade in the situation of comparative advantage in production. Here Ricardo suggests trade should occur between countries where they have different opportunity costs of production, which is the cost of producing a good or service measured in terms of another good that cannot be produced as a result. The idea is that each country specializes in areas where it has the lowest opportunity costs and that thereby global output and efficiency are maximized. His example here was that Portugal might take less labor to produce both wine and cloth than England but that its advantage was greatest in wine, therefore it should concentrate on wine and trade with England for cloth (Ricardo 1821). This provides the logic for countries that are not necessarily the least cost producer to produce and trade in a range of goods and services.

Ricardo's ideas are usually presented in the form of a simple, two-country, two-product static model with labor as its only variable. Two Swedish economists Eli Hecksher and Bertil Olin developed a model that takes into account the difference in various factor endowments, that is the impact of supplies of land, labor and capital on international exchange. The Heckscher-Ohlin (HO) neoclassical factor-endowment model, in the end, excluded differences in labor productivity between nations by assuming that all countries have access to the same technological possibilities for production (Todaro 1985). The basis for trade then, in HO theory is not relative productivity but different factor endowments. This focus on factor endowments led to the idea that international trade will result in a leveling out of prices across the globe and increase the relative price of each country's most abundant resources. Looking worldwide, the implication was that the price of capital from the North would increase and the price of labor from the South increase (Dunkley 2004). This factor price equalization has, quite simply, failed the empirical test, that is, it has not occurred. If anything, capital has become more valuable and labor less so. Nevertheless, free trade remains at the core of both the classical and neoclassical path to development.

The ideas of Smith and Ricardo along with Thomas Robert Malthus provided the basis for one of the three main theories of growth in economics - classical Growth Theory, which emphasized capital accumulation, production, technological advancement, division of labor and population growth.

Neoclassical Economics

Neoclassical economics originated in the early 1870s. When John Bates Clark identified the key postulates of neoclassical economics as: "private property, individual freedom, a limitation of government activity to those fields which Adam Smith had laid down as proper to it, the mobility of capital and labor according to the stimulus of varying remuneration, and, finally the desire of the individual to satisfy certain objective wants" (in Roll 1973), he could equally have been summarizing the key postulates of classical economics. However, neoclassical economics was clearly a break from classicism, starting with its more individualistic approach to society, through to its consequent emphasis on consumption, demand and utility (of conglomerations of individuals), which replaced classical economics' emphasis on production, supply and costs (Roll 1973).

The operational form of the new individualism was a psychological and subjective approach to value, 'utility', which replaced the classical Labor Theory of Value. The utility approach posited that value is determined by a subjective estimate of utility, tied to quantity. The focus on utility went hand-in-hand with the so-called 'marginal revolution', which focused economics on measuring small changes in economic quantities. The research agenda of neoclassicism was initially formed by Gossen's Law on diminishing returns and the theory of marginal utility, which provides a measure of the "alteration in the subjective conditions which would be occasioned by either the disappearance or the addition of some object" (Roll 1973). Thus the focus was on deriving optimal utility by examining marginal increases in consumption.

Another key element of the neoclassical research agenda is its focus on equilibrium – that is where demand and supply are balanced; this occurs at the level of individuals, markets and at the aggregate social level. With the neoclassical basis in individualism, general equilibrium is simply the sum of individual equilibriums. The focus on equilibrium is strongly associated with Léon Walras, but Walras's solution to the equilibrium problem built on the work of Jean-Baptiste Say, in particular, Say's Law, which posits that supply creates its own demand, and therefore there is no oversupply or undersupply of commodities. Examining general equilibrium, Walras theorizes that every demand, or desire to purchase something at a particular price, involves giving up money in order to do so; thus when consumers realize demand they supply someone with money of equal value. Every realized demand is also, effectively, a supply. At the aggregate level, therefore, the aggregate of all demand equals the aggregate of all supply at the general equilibrium price. This is the point of general equilibrium (Gee 1991). Computable general equilibrium models have been very influential in development economics so it is important to be aware of their assumptions, which include: individuals are price takers implying perfectly competitive commodity markets; all firms make the same 'normal' rate of profits implying perfectly competitive factor markets; and there is freedom of entry.

Keynesian Economics

In 1936, with the memory of the Great Depression still very fresh, John Maynard Keynes published his magnum opus, *The General Theory*, which provided both an extensive critique of neoclassical economics and developed an alternative framework for analyzing liberal capitalist economic relations (Keynes 1973, Love 1991). The core point about Keynes' critique is that it finds that capitalist economies will not always tend to a balance between supply and demand, that is equilibrium or, at any rate, an equilibrium that produces full employment. This was due, in Keynes' analysis, to a lack of demand in the economy (Love 1991). The key policy implication was that government can and should intervene in economies to boost demand and thus achieve full employment. So the Keynesian 'revolution' was actually a two headed animal — "…first, the theoretical revolution in economic analysis; and, second, the practical revolution in governmental policies" (Meade 1975).

The General Theory contrasted to neoclassical economics of the time because it functioned as a theoretical tool to understand economic and social problems (Roll 1973). This gave it great contemporary resonance. It provided a comprehensive critique of neoclassical economics and an alternative that remained within the liberal capitalist tradition, maintaining its commitments to markets and private property. Keynes's critique was written with the purpose of saving liberal capitalism (and economics as a discipline) from its tendency to crisis and the associated possibility of a communist revolution and making it function more effectively, not replacing it (Hunt 2002, Robinson 1978). This rationale gives Keynesianism its capacity for diverse theoretical and policy-oriented interpretations that range from relatively conservative market-oriented ones to interventionist and welfare-statist positions.

At the end of World War II, Keynesianism was the dominant economic theory across the West and it penetrated the developing world too. The seeming success of Soviet central planning in the 1930s also furthered interest in statism in the developing world. In the midst of rapid decolonization in the Third World, development and independence were often seen as two sides of the same coin (Rapley 2002). Studying development became vogue and it was in this era that development economics became a discipline of academic study. As John Rapley notes, "[d]uring the 1940s, Keynesianism began finding its way into the work of development theorists. Economists in the Third World read *the General Theory* with great interest. Many obtained their training in first-world universities, where Keynesianism had become prominent by the late 1940s" (Rapley 2002). Thus, in years following the war, development thought was not really left or right, rather there was a widespread consensus that there should be more government intervention in the economy than had previously been the case (Rapley 2002). There was also much optimism that policy-makers now had the right tools and levers to facilitate economic growth, the developing world would soon catch up. This was, of course, a quickly growing developing word – between 1945 and 1965, 65 former colonies became independent nation-states.

Classical Development Economics and Growth

Growth Theory was popular in development economics from the late 1940s through to the mid-1950s. The early models were fundamentally classical ones emphasizing structural change but they did allow for some state intervention to achieve development, showing a Keynesian influence. They saw development as a process of capital formation that was predominately the product of levels of investment and savings. Interest in two particular puzzles permeated the work of these early development economists: the impact of positive externalities from technology, savings and investment on development; and the nature of relationship between positive wages and unemployment in developing countries (Bardhan 1993).

On this latter topic, Arthur Lewis was one of the best know scholars and despite being concerned with anti-colonialism and the rights of labor, his strong classical influences produced a focus on growth rather than distribution (Lewis 1954). Indeed, Lewis largely re-cast the issue of poverty as an employment problem, which made it an acceptable topic for mainstream economists. He posited that Third World economies consist of two sectors: "(a) a traditional, overpopulated *rural subsistence sector* characterized by zero marginal labor productivity – a situation that permits Lewis to classify this labor as 'surplus'… and (b) a high productivity modern *urban industrial sector* into which labor from the subsistence sector is gradually transferred" (Todaro 1985). Lewis was interested in how to get labor to transfer to the modern sector and how to expand employment in it, which in both cases was to be achieved by expanding output. The speed of this expansion is a product of the rate of capital accumulation in the modern sector.

The model relaxed the neoclassical assumption that the supply of labor is fixed (i.e. does not change) but assumed that: the modern sector provides for an excess of profits over wages; all profits are re-invested; wages in the modern sector are constant; and their level is set at a given premium over the subsistence wage in the traditional sector, where the marginal product of labor is zero, meaning labor leaving the sector does not cause a decline in rural output (Levitt 2005, Ros 2005, Todaro 1985). As capitalists reinvest profits, their demand for labor increases but wages remain constant - this process is assumed to continue until all 'surplus' rural labor is absorbed into the modern sector. Only when all surplus labor has been absorbed, does the marginal product of rural labor move above zero and thus its cost increases.

There are quite a number of issues with the Lewis model: first, the assumption that all profits are re-invested and absorb labor at the same rate as earlier investments does not allow for labor-saving technologies, or for the transfer of profits out of the country or into non-productive investments (e.g. financial speculation) (Todaro 1985). Second, the experience of developing countries has not conformed to the model in terms of either the existence of 'surplus' rural labor or constant real urban wages (Todaro 1985). Third, as with Modernization Theory, it was a theory derived from analyzing the experience of Western Europe, which it assumed was applicable for other countries outside of that time and space. Finally, the callousness with which the agricultural sector is treated is quite problematic. Lewis's growth theory could be seen to support programs to extract surplus from agriculture to fund industrial development, and – as is well known now – quite a number of these program came at a high human and environmental cost. It also underestimated the productive capacity of agriculture and its contribution to society – that under-investment in agriculture can be problematic was vividly demonstrated by the food crisis in 2007-2008. Agriculture also plays important social and cultural roles in many societies.

Another key contribution of early classical development economists derived from their questioning of the old 'exogenous' growth theory, which focused on diminishing returns to capital - meaning that as businesses invested additional capital each additional unit would produce a lower rate of return that the previous one. While not denying this, early development economists demonstrated that there was more going on. Paul Rosenstein-Rodan theorized that capital actually produces increasing returns to scale due to the benefits of scale from domestic and international production once countries are developed (Rosenstein-Rodan 1961, Ros 2005). Ragnar Nurkse's (1953) extrapolation found that as more investment in a particular location occurs, the more profitable it becomes but in many developing countries, markets are simply too small to attract investment. This feeds into a vicious cycle on the supply-side where low incomes limit the capacity to save and therefore limit productivity. As Jaime Ros pointed out, bringing together the insights of Rosenstein-Rodan and Nurske with those of Lewis, or of "increasing returns and an elastic labour supply", produced a model suggesting that a developing economy "can be stuck in a poverty trap that can only be overcome through a 'big push'" (Ros 2005). For other early development economists the necessary response to this situation was infant industries protection. This contributed to the development of the policy of Import Substitution Industrialization (ISI), which was a part of the widespread consensus about the way to achieve development that dominated in the immediate post-World War II period. Classically-influenced development economics also influenced the structuralist and Dependency Theory schools of radical development economics examined later in the chapter. Next, however, the chapter turns to an examination of the rise of neoclassical economics and its influence on development theory.

Neo-Marxist Development Economics

The best known leftist traditions of development economics are structuralism and Dependency Theory / World Systems Theory and the latter two have their roots in Marxist political economy. Marx did not have a specific theory of development rather, he sought to identify what was important in capitalist development for achieving further progress of not just the productive capacity of labor power but of expanded freedom for human beings. He drew on classical economics, which said that human labor was the key source of the creation of surplus, indeed Marx's 'labor theory of value' saw labor as the *only* source of value. Marx was also the first political economist to attempt a more holistic analysis of economic system – the Marxian circuit of capital accumulation looks at how capital reproduces itself in the capitalist economy. From his analysis, Marx did not see a self-equilibrating, harmonious system producing efficient and fair outcomes. Rather he saw a system that was, due to the need to consistently accumulate capital, both prone to crisis and exploitation. It was exploitative because it involved those who own the means of production – the bourgeoisie – extracting surplus from those who only own their labor – the proletariat.

There are a number of theories of development inspired directly by Marx, including ones emphasizing the need to follow a non-capitalist path to development and others which draw heavily on Lenin's analysis of imperialism (for an evaluation of his relevance to development economics see Patnaik 2005). However, it has really been neo-Marxist Dependency Theory that has been most influential in development economics and to understand Dependency Theory it is necessary to start with structuralism and the Prebisch-Singer thesis.

Structuralism and beyond

Shortly after WWII, Raúl Prebisch (1950) and Hans Singer (1950) separately published work on First-Third world trade reaching similar conclusions. Prebisch was the Executive Secretary of the UN Economic Commission for Latin America (ECLA) and his work – like many of the neo-Marxists and Dependency Theorists who followed – was focused on understanding and explaining the Latin American experience. Singer had also worked for UN agencies. As Rapley notes, their recommendation:

> would dominate development thinking for years to come, [and it] became known as the Prebisch-Singer thesis. In a nutshell, the thesis was that over time, third-world countries would have to export more of their primary commodities just to maintain their levels of imports from the first world. If they wanted to increase their imports, they would have to increase their exports even more. They called this syndrome the declining terms of trade (Rapley 2002).

The argument was that industrialization causes capital concentration which increases opportunities for collusion and hence higher profit margins; but this does not happen in competitive primary product markets. This means that prices in more industrialized countries would rise more quickly than in less industrialized. Further, demand for primary – especially agricultural – products does not tend to rise with income (that is, there is low income elasticity of demand), whereas demand for manufactured goods does. The implications were that if the Third World continued to rely on primary products they would only sink further into poverty. It was seen that the only way to break free from this trap was to change the structure of economic production.

Structuralism was influenced by Keynesianism and there is a shared concern about unemployment. However, structuralism laid the blame for unemployment firmly in capitalism's structure and said that more fundamental intervention than Keynesian demand management was required to facilitate change (Martinussen 1997) Structuralism was a major inspiration for all the so-called core-periphery models including Dependency Theory and neo-Marxist theories.

Neo-Marxists built both on Marxist insights into the nature of capitalist exploitation and Lenin and other's analysis of imperialism, which sought to show that the imperial system had delayed or defused cyclical capitalist crises in Europe. One of the earliest neo-Marxists was Paul Baran (1957), he argued capitalism operated differently in the Third World than in the First. Whereas in the First World capitalist economic surplus is re-invested and creates growth and dynamism, in the Third World, surplus ends up being transferred to the First World by multinational corporations or used for conspicuous consumption by the local elites. Third World economies therefore stagnate and/or are reliant on external investment for development. In Baran's view, the First world actually hindered the Third's exit from poverty and Westernizing elites in developing countries ruled in alliance with the traditional landed elites to enrich themselves rather than to ensure investment (Rapley 2002).

It was Baran along with Paul Sweezy who in 1968 coined the term 'monopoly capitalism' arguing that the world economy was dominated by large multinational corporations who could exploit Third World countries (Baran and Sweezy 1968). They found that the level of capitalist penetration of the developing world was creating a 'dependent capitalism', resulting in domestic production being undermined by competition from imported products and economic surplus being transferred to the West. A 'comprador' class developed – a local business elite involved in international trade not domestic production, whose interests largely coincided with that of multinational corporations and Western countries. The product of the comprador class and Western capitalist interests was external relations based on economic dependency, which of course helped structure domestic class relations.

Dependency Theory and World Systems Theory

Andre Gunder Frank was a founder of what is sometimes called the Latin American dependency school. Frank (1967) gave a more historical perspective to the study of dependent and exploitative relationships in the world economy; he found that development and underdevelopment were opposite sides of the same coin. He posited that there was a chain of exploitation that ran from: peasants being exploited by local landowners – who extracted surplus by not paying peasants the real value of the commodities they produced - from land owners to local merchants, to regional elites, national elites and eventually Western capitalists (Willis 2005). Frank's model shows the links between various sectors of the economy, where other scholars have talked of two separate sectors – a traditional and a modern one – Frank shows how the traditional sector is linked to the modern one but not necessarily in ways that enable its development, rather in ways that ensure its ongoing underdevelopment (Larrain 1989).

At a broader level, this analysis was also the basis of Frank's distinction between 'core' capitalist countries and the 'periphery,' which saw the core enriching itself by appropriating surplus from the periphery, securing supplies of cheap raw materials and markets for industrial goods and continuing the underdevelopment of the periphery. Early Dependency Theory often saw no prospect at all for any industrialization – although experience proved this incorrect. Later generations maintained that the limited industrialization did not represent an end to dependence – it occurred only in a handful of countries and where specific core country needs could be identified, in particular accessing cheap labor and maintaining market access. Dependence, they argued, was evident in the ongoing lack of transfer of new generation production technology or research and development capacities and, in addition, the repatriation of foreign profit continued to drain reserves. Again, one resultant policy prescription was autonomous national-development strategies and more self-sufficiency (Rapley 2002). The argument was partly a response to the critique that, although Dependency Theory seemed to have relevance to Latin America, its applicability on a world scale was undermined by the success of the East Asian Tigers (Taiwan, South Korea, Hong Kong and Singapore). By the mid-1970s, the Tigers had shown that it was possible to escape the periphery and achieve notable levels of industrialization.

Drawing inspiration from both this critique and from Dependency Theory, Emmanuel Wallerstein developed what came to be known as World Systems Theory (WST). His *magnum opus*, *The Modern World-System*, appeared in three volumes in 1974, 1980 and 1989 and its central argument was that there was, in fact, a single world system in which different parts played supporting roles. In attempting to move beyond the static dualism of Dependency Theory models, Wallerstein identified three key groupings: core, semi-periphery and periphery and argued that countries' location in a grouping was not fixed, it could change over time. This is one of the features that differentiates WST from Marxist and neo-Marxist analysis, which sees a more linear development path for nations (Willis 2005). Wallerstein describes how the flow of surplus from the periphery to the core is organized though various components of the capitalist world system including the international division of labor and through political systems in each nation-state.

A common critique of both Dependency Theory and WST from Marxists is that these theories are not in fact Marxist, because they do not put a nation-state based analysis of class relations at their centre. This is true enough but also shows that Marxists have tended to privilege particular aspects of Marxist methodology and analysis over the broader Marxist emancipatory project, namely understanding, explaining and challenging the exploitation of people under whatever system it occurs.

From Theory to Practice: Imports Substitution Industrialization and Export-Oriented Industrialization

Structuralism, Dependency Theory and classical growth theories were major influences on postwar practices of development, neoliberal development critiques and prescriptions were a response to them. Given the insights of development theories, newly independent states essentially saw three main options for achieving industrialization and growth: (1) autarky; (2) accessing foreign capital to build industrial sector; and (3) using the state to accumulate necessary resources. Most developing countries opted for a blend of (2) and (3) – this is what became known as the strategy of Import Substitution Industrialization (ISI) (Rapley 2002). ISI was seen as a way of generating rapid and self-sustaining growth that would promote economic diversification while, at the same time, attracting foreign capital.

In the 1930s-1950s, ISI was fairly successful meaning it generally produced good growth rates. In the 1960s, the Green Revolution, which utilized irrigation and technology to improve agricultural yields in some crops, resulted in many countries becoming food self-sufficient, including India. The 1950s and 1960s were a time of worldwide economic growth and prosperity, which also accounts for some of the period's economic growth and, as is often the case, things did not stay rosy forever. The spare capacity that fuelled productivity growth was eventually used up and growth declined at the same time as incomes rose. The result was inflation. Declining productivity growth particularly impacted the US and contributed to massive balance of payments deficits that led, in 1971, to the US abandoning the gold standard. The oil shocks, which started in 1973, fed into the problem - the era of stagflation had begun. The second oil shock in 1979 hit the Third World particularly severely producing large declines in commodity prices. In the First World's fight against inflation, interest rates became the major policy mechanism but the hikes in rates also set off the Debt Crisis in 1982.

Faith in the developmentalist paradigm of state planning began to fade somewhat and neoclassical influences again increased. Attention turned to the East Asian Tigers as they continued to achieve high levels of growth. They had started out utilizing ISI strategies but only selectively and often they enforced conditions on industrialists benefiting from government support. Further, from the early 1970s, they started to switch toward a policy of encouraging manufacturers to export internationally competitive goods. This strategy became known as Export Oriented Industrialization (EOI) and became a favorite with neoclassical and neoliberal economies who contrasted it simplistically with ISI, in order to discredit the latter. In reality, the Tiger's selectively pursued some elements of an ISI strategy, in particular protection for infant industries and their EOI strategy involved more government intervention than acknowledged by neoclassical economists. The main features and problems of both strategies are outlined in the box below.

Import Substitution Industrialization	**Export-Oriented Industrialization**
▪ *Aim*: Increase production of locally manufactured goods for domestic consumption via nurturing the domestic market and assist domestic producers to compete against overseas producers who have better technology, economies of scale, skilled workforces, etc. ▪ *Instruments*: tariffs, quotas and/or licensing schemes to protect the domestic market; overvaluing the currency to maintain funds domestically; government direction of foreign investment to particular sectors; requirements that foreign investors have domestic partners; and provision of concessional access to foreign currency or credit to domestic firms. ▪ *Pioneers*: Argentina, Brazil, Chile, India, Mexico, Turkey. ▪ *Problems*: in some cases did not change the structure of economies towards manufacturing or only impacted small sectors of the economy; lack of competition led to issues with low quality, low productivity and corruption; ISI did not create as many jobs as anticipated; and it generally neglected rural development (Rapley 2002).	▪ *Aim*: generate revenue and jobs through production for international market via specializing in areas and developing comparative advantage and ensuring products are internationally competitive (Szirmai 2005). ▪ *Instruments*: in theory based on areas comparative advantage but in practice involved strategic industry policy targeting specific sectors and use of policy instruments to promote an export orientation such as: undervalued exchange rates; preferential access to credit; tax breaks for export-oriented new investments; pay-back of import tariffs on imported inputs used for export production; and strategic reductions of domestic industry protection. ▪ *Pioneers*: East Asian Tigers: Hong Kong, Singapore, South Korea, Taiwan. ▪ *Problems*: initial strategy generally involved a level of control over capital movements that is now difficult; East Asian successes occurred during an era that was more benign to export than is the case currently; it is debatable whether the world market is large enough to sustain many more economies following the export path; and the Global Financial Crisis has demonstrated the problems of export dependency.

From Neoclassicism to Neoliberalism and back again

In the immediate post World War II period, neoclassical development economics was strongly influenced by the Modernization Theory – a historical and sociological theory which aimed to create an alternative to neo-Marxist accounts of development based on need to transform societies from 'simple,' tradition or underdeveloped to complex and modern. However, fairly quickly neoclassical development scholars branched off into many areas and their diversity of approaches makes it difficult to provide a simple summary (Szentes 2005), though this work continued to inform development economics (Bardhan 1993). However, by the 1980s, a new neoclassically-derived development orthodoxy emerged in development economics, which is generally labeled as neoliberalism or, in terms of its more policy-oriented prescriptions, the Washington Consensus.

Neoliberals take as given the neoclassical assumption that individuals are rational and maximize their utility or benefits and from this, the logic runs that the productive economies are ones in which individuals are allowed the greatest freedom to engage in the market and to receive the full rewards of this participation (Rapley 2002). Milton Friedman, neoliberalism's founding father along with Friedrich von Hayek, added to neoclassical economics a focus on demand, consumption, utility and a preference for monetary policy (in particular control of the money supply and interest rates) to address economic cycles over fiscal policy (Keynes' preferred mechanism). This fondness for monetary policy had the added benefit of minimizing state intervention in the economy. Rational expectations theory, which models how people forecast future events, expanded the neoclassical case against the state with the argument that people could increasingly foresee the direction of government policies and would adjust their behavior, thus undermining government attempts to change policy (Rapley 2002).

The neoliberal diagnosis of developing countries' problems actually began back in the 1940s with the work of P.T. Bauer (summarized in Bauer 1981). He did empirical studies which supposedly demonstrated that the rational actor assumption held true for developing countries - up until then it had been common to assume that peasants and farmers or smallholders did not always make 'rational' decisions, that often their decisions were more the product of tradition, culture or superstition rather than rational thought. T.W. Schultz (1965), building on Bauer's work, argued that smallholders do not make capital improvements on their land because of government policies that distort prices and take too much of their profit to fund industrial development. These were the earliest neoliberal arguments against government intervention in developing economies but, by the mid-1960s, there was a rash of literature on the negative impact of many countries' incentive and price structures, exchange rate policies and protectionism on the overall 'welfare' of the economy (Rapley 2002).

In the 1970s, neoliberalism became mainstream amongst development specialists and a 1970 study by Ian Little, Tibor Scitovsky and Maurice Scott (1970) was central to this. The study examined the experience of seven developing countries in the postwar period and concluded that ISI was overall negative, predominately because it did not follow countries' 'natural' comparative advantage and also because of limited bureaucratic capacity to effectively direct ISI (Rapley 2002). It found that ISI increased income inequality and recommended instead that states follow EOI. The 1970 report was relatively cautious in its conclusions and recommended a gradual program of adjusting (Little et al. 1970). But, as Rapley (2002) reports, "[s]tronger — some might say dogmatic — expressions of neoclassical thought were to follow, as critics gained in confidence and grew convinced that their findings had thoroughly discredited the old statist development schools". They also started to recommend more rapid programs of liberalization – 'big bang' approaches.

A further string was added to the neoliberal bow through New Political Economy (NPE). It was pioneered by Anne Krueger (1974) who applied the rational utility maximization thesis to politics via a study of the effect of quotas on firms. She started with the proposition that quotas create economic rents (this is income not due to production but to access to the quotas) and argued that plant managers augment their access to these rents by increasing the capacity of their plants, regardless of current idle capacity (Rapley 2002). They do so to make windfall profits via on-selling of goods purchased under the quota system rather than through growth in actual production. She posited that this capacity to earn rents through non-productive activities would decrease overall plant productivity because, in expanding the size of a plant, the overhead costs of the plant are increased. Moreover, the quota system supposedly expanded corruption in industry and government. Jagdish Bhagwati (1982) came to similar conclusions about the impact of what he labeled "direct unproductive profit-seeking activities". These studies resonated with fellow neoliberals because they seemingly demonstrated that efficiency losses from trade protection were higher than empirical studies had to that point been able to indicate, thus they made the rather weak neoclassical argument in favor of trade liberalization stronger (Toye 1993). This is an important point because, while neoclassical economics is strongly in favor of free trade, it had not convincingly demonstrated theoretically or empirically that free trade produces notable financial gains. Most of its gains were psychological - people having more utility due to access to a wider variety of products. Thus, the strengthening of the argument for free trade, due to losses from protection rather than benefits from trade, was important to the neoclassical and neoliberal position.

Robert Bates' (1981) work built on the neoliberal analysis of urban bias in developing countries' government policy using the NPE framework. This bias supposedly resulted in an inequitable price structure for rural production. Bates explained the bias by the disproportionate influence of urban industrialists allied with the urban working class on government policy in developing countries. Given the neoliberal faith in comparative advantage, Bates regarded this as counter-productive for development. His work was very influential in the World Bank especially in Africa and soon after it was published the Bank's key priority there became 'getting the prices right,' meaning removing price subsidies and cross-subsidization (Rapley 2002). The price issue is a complex one, on the one hand there is evidence that urban bias and getting the prices wrong was part of story of East Asia's successful industrialization, but equally there are examples where getting the prices wrong has hindered development. Getting the prices wrong has also been a common way of providing support to the poor in society. This is because price subsidies are a relatively simple way of providing support in countries with under-developed administrative systems.

Neoliberal critiques were most forcefully expressed in a three volume trade study by the National Bureau of Economic Research (NBER) and in Deepak Lal's (1983/2002), *The Poverty of Development Economics*. Both works aimed to discredit ISI. The NBER report was produced by a team led by Krueger (1983) and it set up a simplistic dichotomy between ISI and EOI, the latter of which was supposedly practiced fully by the successful East Asian Tigers. In countries following ISI, the NBER study said that government interventions distorted relative prices making capital relatively cheap and labor more expensive leading to the elimination of many traditional labor intensive industries but creating few jobs (Rapley 2002). The proposed solution to the problems was, not surprisingly, reduced government intervention across the whole gamut of the economy. Lal's book (2002) was an even broader attack on what he labeled the "dirigiste dogma". The first chapter critiques the postwar development orthodoxy around the need for governments to promote economic development via distortions in the price mechanism, controls on free trade and wealth redistribution and the rest of the book is devoted to reclaiming the centrality of 'getting the prices right' and to demonstrating that government failures are worse than market failures.

NPE and neoliberalism contribute significantly to "a profoundly cynical view of the state in developing countries" (Toye 1993). The proposition that individuals are only motivated by self-interest is, as John Toye (1993) pointed out, an assumption "breathtaking in its scope and pretension," which feeds into pessimism to the point of determinism regarding the capacity of states in developing countries to implement 'sound' policies. This bias contributes to its ultimate inability to undertake historically grounded socio-political analysis of state-market-civil society relations despites its pretensions as 'political' economy. Equally, neoliberal development economics "naturalized" the existence of nation-states and liberal capitalism (Berger 2004).

In summary, the neoliberal analysis of the problems in developing countries comprised three interrelated ideas, that: the public sector was over-extended; there had been too much emphasis on physical capital formation often at the expense of human capital formation; and the Third World had developed too many market-distorting economic controls (Toye 1993). This analysis dominated orthodox development economics for two decades. As a result contemporary development economics literature has tended to focus on issues of economic efficiency and productivity increases in particular sectors in contrast to the early literature, which focused on broader issues of economic growth and capital accumulation (Nayyar 2003).

The neoliberal analysis became widely accepted amongst policy-makers too. This is because its rise coincided with the economic crises of the 1970s for which it purportedly had an explanation *and* a solution. Further, there was: "widespread doubt and anxiety about the wisdom of government activity in many developing countries..." and "some truth" in the neoliberal analysis (Toye 1993). Further, well-funded think-tanks, World Bank researchers and many in the press set out to disseminate neoliberal views (George 1997, Toye 1993). More than anything though, the election of the Reagan Administration in the US legitimized neoliberal economics; the Administration used neoliberal prescriptions to reshape its domestic social, political and economic system and promoted neoliberalism globally, both directly and through international institutions like the World Bank and International Monetary Fund (IMF). Of course, not all developing countries needed to be pushed into neoliberal development directions; neoliberal regimes came to dominate elites in many developing countries, though not all of them by democratic means.

In 1990, John Williamson labeled the development strategy associated with neoliberalism as the Washington Consensus because it was hammered out in Washington between the US Treasury, the World Bank and the IMF (Fine 2001). The strategy did not appear overnight but within a few short years - by the early 1980s – a common set of policy prescriptions could be identified. The prescriptions involved two phases: first, policies to achieve short-term macroeconomic stabilization which were carried out quickly via 'big bang' reforms; and second, policies aims at long-term structural change via a range of detailed microeconomic reforms (see box).

The Washington Consensus

Phase One: Economic Stabilization

1. Budgetary austerity to control deficits —dramatic cuts in recurrent expenditure, in particular cuts in public sector employment, social sector programs and investment programs.
2. Currency devaluation – and ending currency controls or, at minimum, multiple exchange rate policies.
3. Price liberalization —often referred to as 'getting prices right', meaning ending subsidies and price controls.

Phase Two Policies: Structural Reform

1. Trade liberalization — reduction and elimination of tariffs and quotas; export focus.
2. Privatization of state owned enterprises and utilities.
3. Tax reform — preference for value-added taxes that increase the tax burden on lower and middle classes and tax breaks for targeted investment.
4. Land “reform” — a misnomer, essentially refers to ensuring the security and stability of private land ownership.
5. Banking deregulation — detailed changed to legislation, privatization of state-owned banks and establishment of an independent central bank.
6. Liberalization of capital movements, that is the removal of foreign exchange controls.
7. A focus on poverty alleviation and social safety nets was added in the late 1980s, the focus was on cutting overall social expenditure and selectively ‘servicing’ the poorest (a supposedly low cost, efficient approach).
8. Good governance — in the 1980s, this essentially meant the holding of multiparty elections.

(Chossudovsky 1997)

In the wake of the 1982 Debt Crisis, conditionality on loans and aid was the main way in which neoliberal policy prescriptions were implemented. However, at the end of the day, neoliberal policy prescriptions for development have been no more successful than Keynesian ones (Rapley 2002, Rodrik 2007). Indeed, in following these prescriptions many sub-Saharan countries ended the 1980s and even 1990s worse off than when they started, demonstrating that the social costs of neoliberalism have been very high. The failure resulted in a questioning of both its policy prescriptions and underlying theoretical framework.

In fact, across the period of neoliberalism’s dominance, many neoclassical economists continued their slightly more diverse approaches. A good example is Dani Rodrik (2007), who combines a commitment to neoclassical analysis with openness to examining a range of policy options based on the specific situation of each country. For example, in analysing the constraints in China’s agricultural production pre-transition, Rodrik notes that while an economist’s first-best solution would have been land privatization, such an approach would have undermined the country’s tax base, increased urban food prices and been fraught with legal and administrative difficulties. In this context, the Chinese approach of a two-track price system avoided these problems and still created incentives for increased private production (Rodrik 2007). Another example is Amartya Sen (1999), a neoclassically trained development economist who challenged neoclassicism’s commitment to the metrics of utility as a way of measuring people’s well-being (see Bardhan 1993). For Sen, development needs to be understood as a broader process aimed at achieving substantive social, political and economic human freedoms for those with the most constraints — namely, the poor and dispossessed. Freedom must be the ends and means of development, it must be both constitutive and instrumental, where instrumental freedoms include "(1) political freedoms, (2) economic facilities, (3) social opportunities, (4) transparency guarantees and (5) protective security" (Sen 1999).

By the late 1990s, there was a new discernible strand amongst neoclassical development economics, which can broadly be called a New Institutional Economics (NIE) influenced approach. NIE has become a major influence on development economics over the past decade and it has become associated with a set of policy prescriptions labeled the post-Washington Consensus.

New Institutional Economics and Development Economics

NIE expands economists' views of what constitutes market failures. To problems of externalities, increasing returns to scale and monopolies it added issues of information failures and transaction costs. It's research agenda includes: property rights, public choice, quantitative economic history and cognition. The inclusions of these new dimensions led to a picture of markets with extensive imperfections as opposed to the neoliberal view of perfectly working markets (Fine 2001). As Douglass North - a leading NIE scholar – explained, it: "is an attempt to incorporate a theory of institutions into economics. However, in contrast to the many earlier attempts to overturn or replace neo-classical theory, the new institutional economics builds on, modifies and extends neo-classical theory to permit it to come to grips and deal with an entire range of issues heretofore beyond its ken" (North 1998).

NIE does not question neoclassical economics' methodological individualism or the utility maximization assumption as Sen did, however, it does reject its conception of instrumental rationality in favor of bounded rationality, that is the idea that human rationality is constrained by factors such as: "emotional affect, limited cognitive ability and imperfect information" (Kaufman 2007) This creates space to explain the existence of social structures and institutions by individuals who create these, "within and between market and non-market forms of organisation," and it allows institutions and non-market (i.e. social) factors a key role in mitigating market failure and thus improving the efficient functioning of markets (Fine 2001).

One of the most prominent NIE theorists writing about development is Joseph Stiglitz. He shared a Nobel Prize for Economics in 2001 for work on the extent of information asymmetry in markets. This demonstrated, in contrast to the neoliberal view that markets have perfect knowledge and are efficient, that markets are subject to extensive imperfections. One implication was that government action can be efficient in many more circumstances than allowed for by neoliberal and even much neoclassical analysis (Greenwald and Stiglitz 1986). If this is true for developed countries, it is more the case in developing ones, where Stiglitz turned his attention after becoming Chief Economist of the World Bank in 1997. This was precipitous timing, just months before the onset of the Asian Financial Crisis. Stiglitz became a well-known critic of the IMF and their one-size-fits-all approach to development.

Stiglitz (2002) has critiqued the neoliberal push for 'big bang' capital market liberalization. He argues that there is little evidence that it promotes economic growth and that without attention to the order and timing of reforms, it can cause more harm than good. Indeed, it is the case that overall the questioning of neoliberalism amongst mainstream economists has gone furthest in this area of capital market liberalization (Broad 2004). Regarding trade liberalization, Stiglitz acknowledges that East Asian development was in part the product of government intervention and promotion rather than the free market, equally though he argues that "[o]pening up to international trade has helped many countries grow more quickly than they would otherwise have done" (Stiglitz 2002). Nor is he willing to give up privatization, though he highlights the need for strong state regulatory regimes (Stiglitz 2006, Broad 2004).

NIE has become associated with a set of prescriptions labeled the post-Washington Consensus (see box below), which notably expanded the theoretical concerns and interests of mainstream development theory. Essentially, NIE and the post-Washington Consensus expand and/or temper some of neoliberalism's hostility to the state and place greater focus directly on the social sector in combating poverty and improving economic growth. Nevertheless, the 'post' here indicates theoretical and practical continuities with the Washington Consensus rather than it having been supplanted. It is important to note too, that the actual practice of development by major donors, international financial institutions and the like, has not gone as far as some of the discussions might suggest.

The Post-Washington Consensus

- Continuation of the neoliberal conservative approach to monetary and fiscal policy, tempered by greater concern with the pace and sequencing of liberalization given concerns about market failure and applicability to local conditions (Broad 2004).
- Abandonment of one-size-fits-all approaches to development producing greater attention to each country's specific situation. This should result in better developed socio-economic analysis of local conditions as well as consideration of global and regional impacts.
- Recipient government ownership of development programs and projects.
- Expansion of the role of the state as a compliment to, rather than competition for, markets; this is generally in a weak form, meaning state provision of a good policy environment for business – an active, pro-capitalist state (Cammack 2003).

- Greater concern with market failure to complement the neoliberal focus on government failure. This could promote analysis of markets prior to privatization and increased attention to the sequencing of reform programs, in particular the development of adequate regulatory frameworks relevant to local conditions prior to liberalization.
- Increased attention to decentralization as a policy prescription for increasing participation, ensuring local needs are met and improving governance.
- Expanded local participation in the planning, design and implementation of activities and an analytical focus on social capital.
- A greater concern for the social costs of adjustment and poverty in general.
- A slightly broader approach to health and education.
- A reformulated interest in corruption, based on the NIE view of it as the product of government and market failures.

Source: (Engel in press)

Conclusion

Development theory has tended to reflect the trends in economic theory in general - both have shifted between belief in more free market and more interventionist approaches and we often see resurgences of interest in particular approaches or issues. An example of this can be found in the work of Jeffrey Sachs. He was originally a neoliberal development theorist but in the late 1990s he had somewhat of an epiphany – he not only become a little more cautious regarding neoliberal policies but he became pro-aid, indeed, he is now globally one of the best known advocates for ‘Big Aid’ (for Africa in particular). In *The End of Poverty: Economic Possibilities for Our Time* (2005), he proposed a ‘big push’ for poor countries via a doubling of foreign aid to a level of at least $100 billion per annum initially and then double again by 2015. In this formulation, aid again fulfills the so-called ‘financing gap’ between what developing countries require “to break out of the poverty trap and begin growth on their own” and what they actually have (Sachs 2005). In the 1950s, the structuralists – Rosenstein-Rodan in particular – had argued for a ‘big push’ in financing to meet the infrastructure needs of developing countries. The main difference is that Sachs wants development assistance to finance a package of interventions covering the essential needs of poor people. The idea of meeting basic needs too has strong historical antecedents – it was the state approach of the World Bank and other development agencies during the 1970s. A further parallel can be made with Modernization Theory because Sachs undertakes little reflection on the causes of poverty. There are references to accidents of geography and climate but ‘underdevelopment’ just seems to be a stage that can be overcome by getting an assisted step up the ladder of development (Broad 2006). Sachs also demonstrates quite a degree of faith in comprehensive and technocratic planning to meet the needs of the poor – a legacy of Keynesianism and Modernization Theory and an area that has demonstrated quite a number of spectacular failures as well as the occasional success.

What Sach's work and his prominence also demonstrate is that neoliberalism is somewhat on the wane in terms of its dominance in development economics. It is again promoting a little less hostility to the state and more concern with the well-being of the poor. But it equally demonstrates that most development economics remains constrained by its idea or vision of 'development' measured by growth in national income or GDP. One alternative we explored to this narrow approach is the work of Sen who challenged the centrality of utility in development economics. His ideas have helped to mainstream human rights in development practice and are a good place to start in any journey to critically evaluate 'development.' Equally, there are a number of more radical questioning of mainstream economics and its idea of 'rationality' for example in Marshall Sahlins (1974) or Vandana Shiva (1989), whose work suggests that development, or rather 'maldevelopment,' is culturally biased, destroys sustainable lifestyles and creates conditions of scarcity and real material poverty though the diversion of resources to commercial, large-scale commodity production rather than use in the production of basic needs. These kinds of approaches demonstrate many of the silences and weaknesses of traditional development economics.

The recent questioning of neoliberal economic development discourse from within the mainstream remains quite constrained and bereft of a broader vision of human emancipation of the kind displayed in different ways by Shiva and Sen or by the earlier Dependency Theorists. While New Institutional Economics has questioned of the mainstream development prescriptions, its vision too remains limited. Interestingly, this questioning of the limitations of mainstream development economics has been deepened by current events – the Global Financial Crisis has seen a renewed interest in the political economy of Keynes and Marx and other genuinely alternative thinkers in not just academia but in government and the media. This is something to be applauded as political action to achieve genuinely humanist transformation needs to be supported by critical political economic analysis underpinned by a vision of global social justice.

Online Resources

Centre for Global Development: http://www.cgdev.org - an independent, not-for-profit think tank working on global poverty and inequality, has a particular focus on US government activities
Development Gateway: http://www.developmentgateway.org – a development knowledge portal operated by a NGO with funding from donor governments, the World Bank and the UN Development Program
Dev Zone: http://www.dev-zone.org – a New Zealand based site with a great database of up-to-date and independent research on international development and global issues
Eldis: http://www.eldis.org – a development knowledge portal operated by the Institute of Development Studies, Sussex

Real World Economics Review: http://www.pgecon.net – a journal dedicated to providing space for non-neoclassical scholars
UNU-WIDER: http://www.wider.unu.edu – the United Nations University World Institute for Development Economics website.
World Bank: http://www.worldbank.org – the World Bank is one of the largest development organizations in the world. Each year it produces a World Development Report, which is generally a very good guide to current orthodox developing thinking.

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