Development with and beyond the market: in search of economically rational alternatives to neo-liberalism

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Chapter 2

Dependency and Neo-dependency Perspectives

Introduction

To help situate current debates within their historical context, the first section of this chapter reviews the early development literature. Subsequent sections will examine a range of issues which highlight the limitations of dependency and neo-dependency\(^1\) development models. This exercise is undertaken with several aims in mind. The first is to show that the limitations of dependency models should have been more widely appreciated at a much earlier stage. Another is to demonstrate that, even when the deficiencies of these models became all too apparent, many analysts sought to defend a deteriorating research programme by developing neo-dependency models which maintained many of the flawed elements of the original models. Thirdly we identify the reasons why so many analysts took so long to acknowledge the deficiencies of dependency-inspired perspectives.

By drawing attention to the wide range of factors that influence outcomes in developing countries, the discussion in this chapter sheds some light on the limitations of other theoretical approaches. These include those which, unlike the dependency literature, place too much of the analytical burden on the characteristics of the state when seeking to explain why some countries have been more successful at development than others and why certain development strategies were chosen over others. This discussion is especially relevant to consideration in subsequent chapters of the merits of neoclassical political economy and 'statist' political economy perspectives. The comparative study undertaken in section 7 on

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Sri Lanka and Malaysia also provides some insight into the merits of a more ‘basic needs’ approach to development. It also highlights some areas where supporters of neo-liberal economic policies have been highly selective in the type of evidence they consider when making strong claims about the long-term economic damage caused by above-average levels of social spending.

1. Development Economics to Dependency Theory

The first concerted attempts at understanding the economic problems of developing societies were made during the 1950s. Unlike the present time, most economists in this period and over the next couple of decades supported the need for a separate discipline of development economics to address the unique problems of these societies. They also had a more positive view of the ability of governments to intervene to accelerate the development process. Many economists were also of the opinion that a ‘critical minimum effort’ was needed in these countries to break them out of the 'low level equilibrium trap' they were caught in and to set in motion a virtuous cycle of growth. More specifically, it was argued that the proportion of national income invested should be greatly increased (as should the amount of aid they received), most of which should be channelled into industry, which was seen as being the most dynamic sector of the economy.

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2 That is, the merits of governments allocating more resources to areas such as health care, education and nutritional support for the poor than development institutions such as the World Bank have generally suggested is desirable.

3 One reason why scholars became so interested in developing countries in this period was the need to understand what implications the proliferation of new independent states had for the growing cold war rivalry between the western capitalist economies and Eastern block economies. On this see Randall, V. and Theobald, R. 1985. *Political Change and Underdevelopment: A Critical Introduction to Third World Politics.* Macmillan, London, pp. 12-14.

Some economists favoured synchronising the application of capital to a wide range of industries as part of a 'big push' strategy. Others, most notably Albert Hirschman, questioned the necessity of this and suggested that a series of sequential solutions to industrialisation or an unbalanced growth strategy was preferable. Following on from Alexander Gerschenkron, Hirschman argued that benefits could be obtained by deviating from the path followed by the industrialised countries, skipping stages and inventing sequences that had the 'wrong way round' look. More specifically, Hirschman favoured channelling investment into capital-intensive industries which had strong linkages with other industries. He also believed that an unbalanced growth strategy would maximise 'induced decision-making', in that policy makers would be forced to address bottlenecks and other factors that stood in the way of success.

Apart from being influenced by economic theories, early development models were also shaped by sociological theories of development. In the nineteenth century, many evolutionists argued that all human societies were undergoing a movement from the simple primitive to the complex modern. By the twentieth century sociological theories were more sophisticated and attempted to identify the various stages of development in this process, as well as the factors causing them. Walt Rostow and others merged economic analysis with sociological theories of development.

For a very critical review of this literature see Lal, D. 1982. 'Introduction to Volumes 1 and 2.' In Lal, Development Economics: Vol. 1, op. cit., pp. xii - xxviii. For a discussion on whether some recent developments in economics provide renewed support for a 'big push' strategy see Krugman, op. cit.


these perspectives in an attempt to map out the conditions needed to generate development. Apart from the need for an increase in savings and investment, these also included a favourable institutional environment to ensure that the benefits gained would be spread throughout the economy.8

Rostow and other early non-Marxist development analysts have frequently been referred to as modernisation theorists.9 However, as Peter Berger points out, this description is problematical, as the so-called modernisation paradigm is made up of several variables such as capitalism, technological progress, modern institutions and urbanisation, all of which are given different weightings by different theorists. Some theorists place so strong an emphasis on technological progress that they trivialise the economic, social and political differences between countries; others see capitalism as the dominant variable driving the modernisation process. Many features of Marxism itself, especially those which are often subsumed under the label of scientific socialism (such as the claim to be scientific, the espousal of progress and the 'enlightenment' ideals of liberty, equality, and fraternity) are also modernistic. For this reason, neo-traditionahsts (such as Muslim fundamentalists) see Marxism as a twin of capitalism in that both are opposed to traditional forms of society.10

Structuralist Analysis

The early development economic literature was often structuralist in nature, as it focussed on the structural factors that hindered development. Leading early structuralists included

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Gunner Myrdal, Raúl Prebisch, Dudley Seers, and Hans Singer. They argued that governments in developing countries needed to intervene in the economy to accelerate growth by re-allocating labour and capital away from less productive areas to more productive ones, and to ensure a more equitable distribution of income. While economic growth was seen as being necessary to improve social welfare, structuralists were less inclined to assume that these factors were automatically related. Structuralists differed amongst themselves over whether external or internal factors were the main obstacles preventing development. Not surprisingly, given their continent's historical relationship with the United States, many Latin American structuralists strongly emphasised the role of external factors.

**Dependency Theory**

What is generally referred to as the dependency school of development studies emerged from a convergence of two main intellectual trends. One of these, neo-Marxism is, as its name suggests, rooted in Marxist theory. Neo-Marxist analysis differs from more...
conventional Marxist analysis in a number of ways, including the emphasis it places on the influence exerted on developing countries by external economic and political factors, and its pessimistic view of the impact of these factors. Actors besides the industrial proletariat, such as the rural poor, are also believed to possess revolutionary potential. In orthodox Marxist theory, the bourgeoisie is seen as playing a progressive role in helping transform feudal societies into capitalist ones (and in the process creating the conditions for socialism to eventually develop). In neo-Marxist theory they are viewed as a creation and tool of imperialism. The most influential early neo-Marxist theorist was Paul Baran, who argued that capitalist nations had developed by expropriating the surplus of non-European countries by unfair trading practices and colonisation. This left non-European countries in a state of underdevelopment. Baran's ideas were eventually popularised and expanded upon by other neo-Marxist writers such as Andre Gunder Frank and Arrighi Emmanuel.

Dependency perspectives also evolved out of nationalistic concerns in Latin America. This started initially during the great depression and then developed rapidly following the foundation of the Economic Commission for Latin America in 1948. Raúl Prebisch was a central figure in both these periods. The initial focus of Latin American theorists was on the structural problems faced by developing economies. This included the belief that for development to take place governments would need to stimulate industrial development

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19 For a review of these developments see Blomstrom and Hettne, op. cit., ch. 2 and Harrison, op. cit., pp. 75-78.

20 Prebisch, R. Five Stages in My Thinking on Development, op. cit. See also the discussion on his work in Fishlow, A. 1984. 'Comment.' In Meier and Seers, op. cit., pp. 192-196 and Bhagwati, J. 1984. 'Comment.' In Meier and Seers, op. cit., pp. 197-204.
through the use of import substitution policies and other measures. Latin American countries implementing these policies initially met with some economic success. However, economic stagnation set in during the 1960s and Latin American scholars such as F. H. Cardosa, E. Faletto, Theotonio Dos Santos and Osvaldo Sunkel reached more radical conclusions about the limitations of conventional economic theories and about the policies that were needed. While some of the views expressed by these theorists are similar to those expressed by neo-Marxist dependency writers such as Frank, there are significant differences - one of which is that domestic factors were seen as playing a more important role in the development process. Significant forces within developing countries, including elements of the bourgeoisie, were also perceived to have a strong interest in development.

Because many subsequent theorists have been influenced by both sets of perspectives, the dependency literature is not easily separated into neo-Marxist and non-Marxist categories. Furthermore, dependency theorists who have been the most strongly influenced by Marxist theory are not necessarily the ones who are the most pessimistic about the prospects of developing countries, nor the most neglectful of the part played by internal factors. One reason for this is that the literature by neo-Marxist dependency writers also contains, to varying degrees, elements of more orthodox Marxist analysis. For these reasons, I refer to 'strong' and 'weak' versions of the dependency model in this thesis.

The strong version portrays external factors as overwhelmingly dominant and (without radical economic and political changes being introduced within countries and in the global economy) is very pessimistic about the prospects of developing countries. For example,

21 See Blomstrom and Hettne, op. cit., ch. 2; Harrison, op. cit., pp. 75-78; Prebisch, Five Stages in My Thinking on Development, op. cit.


23 On this see Harrison, op. cit., pp. 62-99.
according to Frank, a socialist revolution is needed for development to occur.\textsuperscript{24} Other analysts stress the importance of economic self-reliance and the severance of as many as possible of the links that exist between these economies and the developed economies. In contrast, weak versions of dependency theory place more emphasis on the role of domestic factors and are more optimistic about the chances of development, and of developing countries benefiting from the world economy, if reforms are introduced.\textsuperscript{25}

2. Over-Generalisation

In varying degrees, the dependency literature presents a very negative and generalised picture of the consequences for developing countries in their growing integration into the world economy. The reality has been that the experience of countries has varied greatly. Table 2.1 provides a regional breakdown of per capita GNP growth rates for the 1965-1990 and 1985-1994 periods.

### Table 2.1: Average Annual Percentage Growth Rates

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America</td>
<td>2.5%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>2.0%</td>
<td>2.5%</td>
</tr>
<tr>
<td>South Asia</td>
<td>3.5%</td>
<td>4.0%</td>
</tr>
</tbody>
</table>


Per capita GNP growth statistics (and other conventional development indicators) provide a useful indicator of the relative aggregate economic performance of countries or regions over

\textsuperscript{24} Frank, *Capitalism and Underdevelopment in Latin America*, op. cit.

\textsuperscript{25} For a review of the literature see Harrison, *op. cit.*, pp. 62-99; Ruccio, D. F. and Simon, L. H. 1988. 'Radical Theories of Development: Frank, the Modes of Production School, and Amin.' In Wilber, *op. cit.*, pp. 121-173; Blomstrom and Hettne, *op. cit.*, CHs. 2-4.
time. However, apart from the fact that they tell us nothing about changes in income distribution, the impression they convey of the impact of development can be misleading for several reasons. One problem is that conventional per capita income statistics, which are expressed in US dollars, are insensitive to differences in relative purchasing power. That is, they do not take into account the fact that one US dollar will buy more rice in Thailand than in Japan. To address this problem international organisations such as the World Bank and UNDP (the United Nations Development Program) now measure income to also reflect its relative domestic purchasing power. As table 2.2 shows, when income is measured in PPP (Purchasing Power Parity) dollars the income of many developing countries rises significantly. For example, Malaysia's per capita income for 1994 rises from approximately 42 percent of Korea's to 82 percent, and from approximately 13 percent of the United States' to 32 percent.

Table 2.2: GNP Per Capita Income Estimates for Selected Countries (1994)

<table>
<thead>
<tr>
<th>Country</th>
<th>PPP Dollars to Korea</th>
<th>PPP Dollars to United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>82%</td>
<td>32%</td>
</tr>
<tr>
<td>Korea</td>
<td>100%</td>
<td>82%</td>
</tr>
<tr>
<td>United States</td>
<td>100%</td>
<td>132%</td>
</tr>
</tbody>
</table>


While this new way of measuring economic activity generally presents a more accurate picture of relative living standards than conventional indicators, it still suffers from a number of problems such as a lack of accurate data and the difficulties involved in weighting the various elements and aggregating them to establish the average real income of a country. Both new and conventional means of measuring economic activity also treat

all expenditure the same, and fail to distinguish between that which adds to well-being and that which has a negative effect or is incurred to address the negative side-effects of other expenditure. These include such factors as the costs to governments of cleaning up pollution and the costs to individuals of buying medicines to combat illnesses caused by such things as a lack of clean water. 27 In relation to developing countries, another deficiency with these indicators is that they only register monetary exchanges and fail to take into account the fact that because of barter and free access to communal resources, people in developing countries do not pay money for many of the things they consume such as food, fuel or building materials. A deterioration of the resource base or the increased commercialisation of it can result in the local population paying for resources (or substitutes) that they once obtained free.28

3. Colonialism and Underdevelopment

A strong claim made in the dependency literature is that colonialism held back development in the developing world and is to blame for many of the problems experienced in the post-colonial era. Colonialism was undoubtedly often extremely brutal and exploitative, and had other consequences such as the spread of disease. The ethnic conflicts that plague many developing countries have their roots in the colonial era,29 as do many of the problems associated with unequal access to land.30 Many countries (especially African ones) were

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29 This has particularly been the case in Africa where the national boundaries that were drawn by colonial rulers took little account of ethnic divisions.

30 As in the case of many Latin American countries where large estates were developed under colonial rule.
also left with a legacy of fragile political institutions and suffered from a loss of skilled personnel after independence.\textsuperscript{31} Despite these factors, the 'colonialism as a major cause of underdevelopment' contention is flawed in a number of respects. For, while some of the most backward countries in the developing world were once colonies, many of them were not. In addition, some of the most advanced developing countries such as Malaysia, South Korea, Taiwan, Singapore and Hong Kong were once colonies.\textsuperscript{32}

Some dependency theorists attempted to address such inconsistencies by arguing that capitalism penetrated every developing society, making it dependant whether or not it was formally colonised. In the process, capitalism was redefined, with its origins traced back to the 15th and 16th centuries. According to Frank and Immanuel Wallerstein, capitalism exists whenever or wherever direct producers have assigned their produce to the market and have been deprived of the economic surplus which they helped create.\textsuperscript{33} As Stuart Corbridge points out, this expanded definition of capitalism contains a number of inconsistencies; specifically, why then did capitalism begin as late as the fifteenth century?

After all, if capitalism is no more than a system of exploitative production for the market, it surely also shaped the lives of the slave on the Roman latifundium or the gleb serf of the European Middle Ages, at least in those cases - the overwhelming majority - where the lord assigned part of the economic surplus extracted from the serf for sale. Indeed by this logic we could conclude that from the neolithic onwards there has never been anything but capitalism. By inventing a definition of capitalism for their own political reasons, Baran and Frank have ensured that modern neo-Marxism is bereft of historical and spatial sensitivity.\textsuperscript{34}

A more specific criticism of Frank and Wallerstein's approach is that it does not shed any light on why countries with similar colonial histories such as Argentina and Egypt experienced significantly different outcomes. By 1880 the latter was in economic crisis. As


\textsuperscript{32} Those countries which were not colonies include Afghanistan, Tibet, Nepal, and Liberia. For a discussion on these issues from different perspectives see Harrison, \textit{op. cit.}, p.111; Berger, \textit{op. cit.}, p.126; Bauer, P. T. 1981. \textit{Equality, The Third World and Economic Delusion}. Methuen, London, ch. 4.


Egypt had received large amounts of British investment, and was permeated with foreign influence, it could be argued from a dependency perspective that this explained the problems they faced. However, Argentina had also received large amounts of investment, and foreign interests also exerted a strong influence. Yet, unlike Egypt, Argentina was on the way to becoming one of the richest countries in the world during this period.35

A comparison between Argentina and Australia is also instructive. Both countries are rich in natural resources, both received large amounts of foreign investment, and both, in the early decades of this century, were amongst the richest countries in the world. These countries subsequently underwent markedly different development experiences. According to Frank this was because

Australia did not inherit a class structure like Argentina’s. Apparently, as a result of the discovery of gold there [Australia] in 1858, a working class evolved which proved able to oblige the government to adopt effective policies of protectionism and rural immigration for reasons of self-interest rather than development. It was these policies that made development possible in Australia.36

This explanation is clearly inconsistent with the central tenet of Frank's writings which emphasises the relative unimportance of domestic determinants.37

4. Dependency and Underdevelopment

A key postulate of much of dependency analysis is that a strong causal link exists between a state of dependency and a state of underdevelopment. The problem for dependency theorists is that they are unable to show that there are any unique characteristics which so-called dependant economies possess which are the cause of underdevelopment rather than a consequence of it. As Sanjaya Lall points out, this failure means that their interpretation of what constitutes a state of dependency almost inevitably involves a good deal of circular


36 Cited in Harrison, op. cit., 1988, p. 83. See also Frank, Lumpenbourgeoisie, op. cit., pp. 55-56.

reasoning:

Less developed countries (LDCs) are poor because they are dependant, and any characteristics that they display signify dependence. In such tautologous definitions, 'dependence' tends to be identified with features of LDCs which the economists in question happen to particularly dislike, and ceases to offer an independent and verifiable explanation of the processes at work in the less developed world.  

A more specific problem with the dependency concept is that many developed economies such as Australia and Canada fit many of the criteria laid down by dependency theorists of what constitutes a dependant economy. This includes the large amount of foreign investment in both economies, the heavy and extended reliance by Australia on primary industries, the unequal nature of the relationship between Canada and its powerful neighbour the United States, and (prior to the Second World War) the subordinate relationship which Australia had with its ex-colonial master Great Britain.

5. Foreign Investment

In attempting to identify more specific mechanisms by which developing countries were exploited and kept in a state of underdevelopment, many dependency theorists focussed on the so-called exploited surplus - that is, the flow of money out of a country above that which was initially invested in it.  

This approach ignores the reality that even when large or excessive profits are made in this way, the host country often still accrues benefits it would otherwise not have received. In his book 'The Economics of Feasible Socialism', Alec Nove illustrates this point by reference to Chekhov's famous play 'The Cherry Orchard':

In the last act, an impecunious landowner enters with a happy smile, and starts repaying his debts. 'Look what happened! Two Englishmen came and found some

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sort of white clay under my land and have paid me all this money.' Can it really be argued that the under-development of the then Russian Empire was due in any way to these two Englishmen? They may have made a lot of money out of the clay, it would no doubt have been better for the host country if its own entrepreneur had invested in this clay, but the fact is they did not, and the Englishmen did not prevent them from doing this, but got their opportunities because they were not doing so.41

Many dependency theorists also attach far too much importance to short-term capital flows at the expense of other factors. The danger of this is illustrated by the following example. In 1975 the United States invested $178 million in Latin American manufacturing industries. In the same year, $570 million was returned to the United States in profits, fees and royalties. According to the argument put by many dependency theorists, this meant that a decapitalisation of $392 million had occurred. What this calculation failed to compare was capital outflow against total US investments in Latin America, which in this period was $8.6 billion. The $392 million mentioned amounts to a 4.6 percent return on this investment which is not an exorbitant rate of return.42

The Long-Term Influence of Foreign Investment

Another argument put by dependency theorists is that foreign investors were able to distort the development process in ways that were harmful to the long-term interests of a country. As table 2.3 indicates, a major problem with this perspective is that some of the poorest economies in the world have low levels of foreign investment while some of the most successful developing economies have high levels of foreign investment. The view that the investment practices of multinational corporations (MNCs) have been a major cause of underdevelopment is also difficult to sustain as a generalisation, given that in the decades following independence they accounted only for approximately 2.5 percent of total investment in developing countries.43 However, there have undoubtedly been many occasions when developed countries, especially the United States, have supported oppressive regimes or have helped overthrow governments to protect the financial interests

41 Nove, op. cit., p. 185.
42 Smith, op. cit., p. 63.
of their MNCs and/or for politically strategic reasons, and this had disastrous long-term social and economic consequences.\textsuperscript{44}

Table 2.3: Net Foreign Direct Investment (FDI) for Selected Countries


6. TheDeclining Terms of Trade Thesis

Historically, the sale of primary commodities (see table 2.4) has accounted for a large proportion of the exports of developing countries. According to many dependency theorists...
and many third world leaders) one of the principal reasons why many developing countries have not been more successful at development is that their commodities are subject to a declining terms of trade (DTOT) relative to the manufactured goods they import from the industrialised nations.\textsuperscript{45}

\begin{table}
\centering
\caption{Percentage Share of Primary Exports in Total Exports}
\begin{tabular}{l}
\end{tabular}
\end{table}

One criticism made of the methodology employed by advocates of the DTOT thesis is that the figures most often cited (those by UNCTAD) are distorted, as they start when commodity prices were high world-wide because of the Korean War.\textsuperscript{46} The UNCTAD


\textsuperscript{46} Balassa, 'Comment.' \textit{op. cit.}
terms of trade index also compares the price of primary commodities against the unit value of manufactured goods. While this simplifies the process, it can also result in price rises of manufactured goods being overestimated, as the unit value is measured by the ratio of value to weight and does not take into account the trend towards lighter materials. Adjusting for these factors, both Bela Balassa and Irving Kravis and Robert Lipsey conclude that the terms of trade of developing countries increased between the years 1953 and 1977. According to Balassa, when further adjustments are made for changes in the quality of the manufactured goods imported, an even more favourable outcome for developing nations results.

World Bank economists E. R. Grilli and M. C. Yang have addressed more extensively the issue of whether adjustments for unit value and quality biases will produce results that undermine the DTOT thesis. In contrast to Balassa, they found that between 1900 and 1986 the terms of trade of non-fuel commodities declined significantly relative to the manufactured goods of the industrialised countries. However, as they point out, the price of a product is only one of the factors affecting profits on resources and per capita incomes. Other important factors are increases in productivity through the introduction of new technologies and investment in human capital. Grilli and Yang conclude that the decline in the net barter terms of trade for developing countries has been compensated for by a steady increase in their income terms of trade. Even if this had not been the case, other factors might be responsible, such as poor domestic management.

47 Ibid.

48 Kravis and Lipsey’s conclusion is that there was actually a 6 percent decline in the terms of trade of the developed nations in this period. Balassa (ibid.) has adjusted these estimates by replacing the UN index of primary commodities with that of the World Bank’s, which shows a higher increase - 154 percent compared to 145 percent. His conclusion is that between 1953 and 1977 the decline in terms of trade suffered by the developed countries in their exchange of manufactured goods for the primary products (other than fuel) of the developing countries was 10 percent.

49 For example, the price of machinery and transport equipment in the United States rose by 105 percent between 1953 and 1977. However, when he adjusted the price to take into account the higher quality of the equipment, Balassa (Ibid.) concluded that the real price rise had only been 77 percent.

50 Grilli and Yang, op. cit.
Whether or not Grilli and Yang's conclusions are valid, the statistics provided in table 2.4 suggests that countries have had more opportunity than the dependency literature suggests to diversify from commodities that are declining in price, in search of better trading opportunities. In many cases, a strong relationship exists between the success and failure of countries to take this opportunity and the capabilities of their respective governments. However, despite the impression given in a good deal of the neoclassical literature (see chapters 3 and 4) other important factors also need to be considered.

Rising world prices have often encouraged a country to over-invest in a particular commodity, as was the case with Zambia with its copper industry. It is easy, with the benefit of hindsight, to condemn countries for not using more of the profits from their commodities when prices were high in order to diversify their economies. When faced at the time with uncertainties about the future direction of world prices, policy decisions were often less clear-cut, as banks and homeowners in many western countries found to their dismay in the 1980s. Indeed, the information environment in which market agents operate is generally not as rich as neoclassical theory assumes (see chapter 3).

Apart from the direct opportunity costs associated with an over-investment in commodities, additional costs arise when the business and labour interests generated mobilise to resist any changes in policy. Resource booms also tend to encourage an unsustainable growth in the public sector which then also resists any changes (e.g. staff cuts). The strength of the political interests that develop can vary greatly from country to country, depending on such factors as the type of commodities and the time period involved, and class, ethnic and other

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51 For a discussion on this see Auty, op. cit. pp. 31-33.


dynamics at work within the country.\textsuperscript{54}

7. **Comparative Study: Malaysia and Sri Lanka**

As previous sections have shown, the dependency literature's analysis of development issues is seriously flawed in a number of respects, including the passive role assigned to domestic factors and the overly generalised conclusions reached about the consequences for developing countries of their growing integration into the international economy. To shed further light on the limitations of the dependency model the following case study compares the experiences of Sri Lanka and Malaysia. This case study also highlights some other issues of relevance to this thesis, including an appreciation of the limitations of one-dimensional neoclassical political economy explanations for why certain development strategies are chosen over others. It also provides insight into the merits of a more 'welfare oriented' approach to development, as well as provides a good example of the tendency of many supporters of neo-liberal economic policies to make strong unsubstantiated claims about the negative long-term economic consequences of social spending.

7.1 **Background**

Malaysia and Sri Lanka are similar in a number of respects. They are both ethnically diverse, ex-British colonies which were left at independence with a well-developed bureaucracy and a relatively sophisticated democratic political system. Other similarities include a strong reliance on flourishing, export-oriented, tree crop plantations and high literacy rates.\textsuperscript{55} In the early 1960s, the per capita income of Malaysia was twice that of Sri Lanka. Three decades later the GNP per capita income of the former had expanded to over

\textsuperscript{54} For a discussion on this see Auty, R. M. 1994. 'Industrial Policy Reform in Six Large Newly Industrialising Countries: The Resource Curse Thesis.' \textit{World Development} 22 (1): 11-26; Auty, Patterns of Development, \textit{op. cit.} See also the discussion on this issue in chapter 4.

five times that of the latter.\textsuperscript{56} A more positive picture of Sri Lanka's relative performance is presented (see figure 2.1) if incomes are adjusted to reflect their domestic purchasing power (that is, in PPP dollars rather than US dollars). When this adjustment is made, Sri Lanka's 1994 income rises from 19 percent of Malaysia's to 37 percent.

\textquote{Please see print copy for image}'

\textsuperscript{*}There are no PPP estimates for the 1960s.


When evaluating the relative performance of the two countries, there is also a need to take into account the fact (see table 2.5) that Sri Lanka managed to obtain levels of improvement in areas such as health care and education which were well above the developing country average, and above what is normally obtained for a country at its level of income. Supporters of a more 'basic needs' or 'welfarist' approach to development argue that a strong link exists between Sri Lanka's success in these areas and its high levels of social spending prior to the change of government in 1977.\textsuperscript{57} Critics of Sri Lanka's welfare-


oriented approach argue that Sri Lanka's high levels of spending on such areas as food subsidies, health and education are a major reason why its economy has not grown as rapidly as those of more dynamic Asian economies such as Malaysia. Some of these critics also question whether such spending has been particularly beneficial, and suggest that the country's social gains are mainly the result of other special determinants such as historical or climatic factors.58

Table 2.5: Sri Lanka: Social Indicators for Selected Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Indicator</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>Average for all low income economies</td>
<td>Not available</td>
</tr>
<tr>
<td>1960</td>
<td>Estimate is for 1952</td>
<td></td>
</tr>
</tbody>
</table>


7.2 Welfare Spending and Social Gain

One of the most highly respected advocates of a more welfarist approach to development is Amartya Sen. According to Sen's calculations, economic growth alone would have taken anything from 58 to 152 years (depending on the assumptions made) to bring about the social improvements that were obtained in Sri Lanka. To reach this conclusion, Sen first determined what level of per capita income a country needed to achieve in order to obtain, on average, similar social gains to those achieved in Sri Lanka in 1975, with its then per capita income of US$130 (expressed in 1975 dollar values). This was found to be US$2,684. Sen then estimated how long Sri Lanka would have taken to achieve this level of income if resources had been spent on investment rather than on welfare.

One problem with Sen's approach is that if Sri Lanka had spent less on welfare prior to 1975, its income in that year would have been more than the $130 it actually achieved, with the result that the gap needed to be bridged would have been smaller. For this and other reasons, S. Anand and M. Kanbur used an alternative approach and carried out a time series regression of the country's living standards for the 1960-78 period, using welfare expenditure and per capita income as the two explanatory variables. The conclusion reached supports the views of those favouring increased social spending in developing countries. As regards reductions in infant mortality, a dollar spent on health care was found to have approximately twenty-five times the positive impact of a dollar spent on investment and growth. A later study by Anand and Ravallion also reached similar conclusions about the benefits of welfare spending, although in this study the relative benefits were slightly less.

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59 Sen, Public Action and the Quality of Life in Developing Countries, op. cit.
60 Ibid.
61 On this see Osmani, op. cit.
These studies could, of course, have ignored some other significant or unique features which might account for most of the gains attributed to welfare spending. In fact, according to S. S. Bhalla, a leading sceptic of the attainments credited to welfare spending, Sri Lanka's health advances are the result of its 1946 malaria eradication program. This argument is flawed for several reasons. In the first place, the most detailed studies available show that this program could only have accounted for a fifth to a quarter of the reduction in the death rate. Secondly, as S. R. Osmani points out, Bhalla curiously characterises this program as 'exogenous technological change' - that is, (as discussed more extensively in the following chapter) he is of the opinion that technological progress is not related to the level of investment in an economy or, for that matter, in the world economy. Apart from the more general criticisms that can be levied against this perspective, Bhalla's conclusion does not explain why many other countries did not obtain the same substantial benefits from DDT use, and more specifically, it ignores the fact that the malaria eradication program succeeded in Sri Lanka because it was an integral part of its health expansion program which was already in place. A third problem with Bhalla's argument, as well as any other attempt to downplay the role of welfare spending in improving social wellbeing in Sri Lanka, is that other countries which have also acquired social gains well above average for their level of income have also spent heavily on welfare. These include China, Cuba, Vietnam, Costa Rica and Chile. All of these countries are unlikely to possess unique characteristics which can be said to account for the bulk of these gains.

7.3 Welfare Spending and Long-Run Growth

While social spending in Sri Lanka could undoubtedly have been better targeted and

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64 Bhalla, Sri Lanka's Achievements: Fact and Fallacy, op. cit.
66 Osmani, op. cit.
67 Ibid.
68 Ibid.
and food subsidies are often a costly way of improving the welfare of the poor,
the argument that such spending is a major reason why the Sri Lankan economy has not grown as rapidly as those of more dynamic Asian economies such as Malaysia does not stand up to close scrutiny. For one thing, the Malaysian government also spent heavily in areas such as education and health care as well as on other initiatives whose primary aim was to satisfy certain social goals such as maintaining or improving the lifestyle of Malays in the rural areas. In addition, the main trade-off in Sri Lanka was not between welfare spending and investment but between welfare and defence spending. As figure 2.2 shows, prior to the change of government in 1977 Sri Lanka had high levels of welfare expenditure and low levels of defence expenditure. Following the change of government this situation was reversed, with little variation in the overall amount of government spending.

"Please see print copy for image"


71 Bruton, op. cit., p. 368.
The view that pre-1977 welfare spending has shouldered too much of the blame for Sri Lanka's poor economic performance is further supported by figures showing that the level of domestic savings was essentially the same as in other developing countries prior to 1977, and that in the ensuing period (1977-85) it actually decreased slightly. As Osmani points out, all this suggests that the surge of investment which occurred after 1977 was not the result of an increase in domestic savings brought about by a decrease in welfare spending, but rather almost solely the result of a 'vastly increased flow of foreign resources.'

7.4 The Role of Politics, Ideology and Culture

Another reason given in the neoclassical literature for Malaysia being the more successful of the two countries is the ideological factors that caused Sri Lanka to choose an inferior, inward-looking development strategy in which, rather than simply import them from more advanced countries, the attempt was made to produce many capital and skill-intensive manufactured goods domestically through the use of an import substitution industrialisation (ISI) strategy. As the discussions in chapters 4 and 5 demonstrate, Malaysia's export oriented industrialisation (EOI) strategy was a superior development strategy. However, the significance of this should not be overstated, as other determinants also had an important bearing on outcomes in both countries. A critical difference is that Malaysia managed its racial problems far more effectively. Aside from costing thousands of lives, ethnic tensions have had a disastrous effect on the Sri Lankan economy, including on its capacity to attract investment and tourism. Malaysia also had a stronger resource base. In fact, oil was discovered at an opportune time in its development process.

Critics of Sri Lanka's inward-looking approach have also exaggerated the role that ideology played in the choice of a development strategy. As a World Bank comparative study of Malaysia and Sri Lanka by Henry Bruton and associates acknowledges, the latter's experience with trade over a thirty year period prior to independence in 1950 had not been a

72 Osmani, op. cit.
73 Ibid.
74 Bruton, op. cit. pp. 327-72.
75 Ibid., p.369.
positive one, due to a combination of the sluggish 1920s, the great depression of the 1930s, and the Second World War. Most predictions for the world economy in the period immediately following the war were for a return to the 1930s situation, and not for the massive increase in international trade that actually took place. In these circumstances, the new country's pessimism about its future trade prospects was hardly illogical at the time. In contrast, when Malaysia obtained independence in 1957 world markets were growing strongly, and its expectations about the potential benefits of trade were far more positive.  

The World Bank study also found that cultural factors had a critical bearing on outcomes, as they resulted in Sri Lankans accepting more constraints on growth because these cultural elements represented important features of Sri Lankan society (particularly Sinhalese society) to which great value was attached. According to the study, such issues as the land development schemes and a reluctance with respect to foreign investment all 'suggest a casual attitude towards growth as such in Sri Lanka'. While the study acknowledges that, to some extent, such constraints on growth were also a feature of the Malay culture in Malaysia, this was obviated by the importance placed on growth by Malaysia's powerful Chinese community. In his studies of the Sri Lankan economy Mick Moore also identifies these cultural constraints to growth, although he places more importance on the role played by various sections of the ruling elite in Sri Lanka, including, antithetically, successful capitalists, in encouraging the deepening of anti-capitalistic values within the general community in order to serve their own political ends.

76 Ibid., pp. 368-369.
77 The Sri Lankan government introduced various land development projects to make more land available to small farmers and to the landless. Most of the land freed up for use in these projects came from the Dry Zone of the country. Because this zone is where the ancient Sinhalese civilisation (the Kandyan Kingdoms) was situated, this meant that these schemes had a strong historic and nationalistic appeal (ibid., p. 91.).
78 Ibid., pp. 369-370.
79 Ibid., pp. 369-370.
8. Responses to a Deteriorating Research Programme

8.1 Returning to First Principles

Some analysts responded to what they perceived were deficiencies of the dependency approach by reverting to a more orthodox form of Marxist analysis in which capitalism is seen as a necessary step on the road from feudalism to socialism and eventually communism.\(^1\) An early Marxist critic of dependency theory was Bill Warren, for whom colonialism, rather than hindering development, had acted as a powerful modernising influence which introduced social change. In the post-colonial era, capitalism had rapidly permeated through developing societies, increasing productivity and generating the dynamics needed for industrialisation and general economic development. In support of this view, Warren pointed to many other factors already mentioned in this chapter, including the point that the development prospects for a number of developing countries were clearly more favourable than the impression presented in the dependency literature.\(^2\)

Unfortunately, such valid insights were marshalled to defend a theoretical framework that was just as limited as that of dependency models. In Warren's model, external political and economic factors were relegated to relative insignificance, with internal class relations being the dominant force driving the evolution of economies. This conclusion ignores, among other things, the fact that by the 1970s, commercial borrowing had begun to overshadow foreign direct investment as a source of external capital in many developing countries. This meant that, over time, supply shocks and global macroeconomic trends could have a profound effect on the development prospects of many countries.\(^3\)

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\(^2\) Warren, op. cit.

8.2 Neo-Dependency Perspectives

World Systems Theory and New International Division of Labour (NIDL) models attempted to overcome some of the perceived deficiencies of dependency analysis while still maintaining as its central focus the relationship between the international economy and national economies. However, while dependency theory is only concerned with development in late-industrialising societies (and even then largely with macro-level development aggregates) these two approaches are more interested in the relationship between structural changes in core regions or cities and the development or underdevelopment of the global periphery. In Wallerstein's world systems model which contains a core, a semi-periphery (e.g. the NICs) and a periphery, the world economy is seen as one integral capitalist system on which individual states have little influence. World systems theory differs from strong versions of dependency theory in that developing countries are considered to have a greater opportunity to develop. However, unlike weak versions of the dependency model, this is seen as being related to the forces of the world system rather than to the internal dynamics of countries.

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89 For a discussion on the differences between world systems theory and dependency theory see Henderson, *op. cit.*, pp. 12-16; Harrison, *op. cit.*, ch. 3 and 4; Hoogvelt, *op. cit.*, ch. 5 and 6;
According to advocates of NIDL models such as F. Frobel, J. Henrichs and O. Kreye, world systems theorists paid too little attention to the central elements of the dynamics driving the world system, namely 'the nature, distribution, and interrelationships of labour processes across the globe.'

NIDL theorists use as their starting point the rapid advances in management, technology, and communications that are having a profound effect on the structure and integration of the world economy. They argue that this movement towards globalisation has been facilitated by the development of Taylorist and Fordist production processes, in which the work process can be split into segments and situated in different locations. The emphasis, therefore, is not so much on the sectorial specialisation between developed and developing countries but on a division of labour between high-level and low-level technological components within each product group.

NIDL theorists are more optimistic than dependency theorists about the development prospects of some developing countries. However, they are pessimistic about how deep and widespread development would be, arguing that many of the jobs relocated from developed countries require little skill and do little to upgrade the skills of the new country. Much of the employment generated, they claim, has only weak linkages with the local economy and is often located in export processing zones, paying little tax while receiving subsidies and other assistance from the host nation. NIDL theorists maintain that as these factories use outmoded, or less than state-of-the-art technology, they provide little in the way of technological transfer.

A fundamental problem with the NIDL literature (including even some less deterministic post-Frobel, Henrichs and Kreye approaches) is that it still pays insufficient attention to the importance of the nation state and the social forces within it such as class, race and ethnic groups. Because their central point of reference is the global dynamics driving the

Blomstrom and Hettne, op. cit., pp. 184-197.

90 Henderson, op. cit., p. 16.

91 Ibid. See also several authors in Higgott and Robison, op. cit.

92 Henderson, op. cit., pp. 12-16. See also Frobel, op. cit.; Higgott and Robison, op. cit.

93 Henderson, op. cit., p. 20.
international economy, NIDL theorists are unable to adequately account for the enormous differences between developing countries. They cannot explain, for instance, why the semiconductor industry first appeared in South Korea, Hong Kong and Taiwan, and not in Indonesia, Thailand or the Philippines, or why some countries such as those in Sub-Saharan Africa experienced major reversals in fortune.

It is also a fact that most Foreign Direct Investment (FDI) goes to relatively high-income economies to take advantage of affluent markets. For example, in 1990 Japan's FDI totalled US$56.9 billion. 73 percent of this investment went to the United States and Europe and 6.4 percent to Australia. Only 5 percent went to North East Asia and 7.4 percent to the rest of Asia. Even in developing countries, a significant proportion of the foreign investment flowing in is motivated by the desire to access domestic markets (which are often heavily protected) rather than the desire to cut costs.

9. Conclusion

For many years, analysis of development issues within the social sciences and on the political left was strongly influenced by the theoretical frameworks developed within the dependency literature. As this chapter has shown, this literature generally attached far too little importance to the role played by domestic factors in influencing the way developing countries integrated into the world economy, was often highly selective in its use of evidence when examining the consequences of this integration, and was unable to offer an

94 Ibid., p. xvi.

95 Ibid., p. 162.

96 An often forgotten fact is that prior to the first oil shock in 1973, the average real per capita GDP growth of countries in Sub-Saharan Africa was relatively impressive. Between 1965 and 1973, it was almost three times the average for South Asia and almost as much as the then rapidly developing economies of Latin America. On this see Auty, Patterns, op. cit., p. 31.

97 East Asia Analytical Unit, Department of Foreign Affairs and Trade. 1992. Australia and North-East Asia in the 1990s: Accelerating Change. Australian government publishing service, Canberra, p. 201.

adequate explanation for what constitutes a dependent economy. Such limitations ensured that the dependency literature was unable to explain why some developing countries were far more successful than others or to provide much insight into the policies that were required to improve outcomes in less successful economies.

While it is easy, with the benefit of hindsight, to fall into the trap of being unduly critical of analysts from another era, the deficiencies of dependency analysis should have been more widely appreciated at a much earlier stage. Even when the success of several Asian economies and other developments within the world economy made it impossible to continue to ignore the limitations of such over-generalised frameworks, many social theorists still demonstrated a remarkable degree of reluctance to come to terms with the deficiencies of dependency models. As the discussion on neo-dependency models demonstrated, many theorists sought to retain many of the flawed elements of dependency models by making what were essentially only relatively minor modifications to their existing theoretical frameworks.

According to Booth, the reluctance of so many analysts to come to terms with the deficiencies of their theoretical models can be largely explained by the fact that to do so it would have been necessary to accept that essentially all Marxist theory, not simply dependency theory, is fundamentally flawed. He, and others such as Hugh Stretton and Lionel Orchard, are of the opinion that rather than explore how they could be changed, all Marxists share 'a metatheoretical commitment to demonstrating that the structures and processes that we find in the less developed world are not only explainable but necessary under capitalism'.

Booth's conclusions led to a heated debate within the social science community, with many criticising him for concentrating on a too narrow range of perspectives expressed in the


Marxist development literature, or of simply getting it wrong.\textsuperscript{101} Undoubtedly, the Marxist literature does contain a wide range of views. However, as the above discussion demonstrates, Booth's evaluation also fits a large body of influential Marxist-inspired development literature. This includes that of Warren and his followers, whose criticisms of dependency theory were motivated largely by their own dogmatic attachments to a far more orthodox, but equally flawed and deterministic Marxist analytical framework.

The above discussion on Warren's input into the development debate also points to a more general problem with the approach taken by social theorists to economic and social issues. As Booth points out, many of the more valid criticisms made of dependency models in Warren's book \textit{Imperialism: Pioneer of Capitalism} were simply a reiteration of perspectives that had already been widely expressed in the mainstream economic literature and which had been strongly supported with solid evidence and argument. This included the extensive evidence provided in this literature of significant progress in many developing countries.\textsuperscript{102} The fact that Warren's publication could still generate the type of controversy normally associated with ground-breaking research indicates how reluctant many social scientists were to consider evidence or argument presented in the mainstream economic literature. As shown in the previous chapter, and expanded on in subsequent chapters, this situation has not necessarily improved much in the interim period.

By drawing attention to the wide range of factors that influence outcomes in developing countries, this chapter has also identified the limitations of some other theoretical approaches, particularly those which place too much emphasis on the capabilities of the state when seeking to explain why some countries are more successful than others, and why certain development strategies are chosen over others. Sections of the neoclassical political economy literature, especially, have tended to view economic success or failure almost solely in terms of 'good' or 'bad' government. However, as both the comparative study of


\textsuperscript{102} On this see Booth, Marxism and Development Sociology, \textit{op. cit.}
Malaysia and Sri Lanka and the discussion on the political dynamics associated with rising commodity prices demonstrated, there is often far more to economic success or failure than such one-dimensional explanations imply. As explored further in chapter 4, such discussions also raise some concerns about the approach taken in sections of the ‘statist’ literature.

The comparative study of Sri Lanka and Malaysia also highlighted the willingness of the more zealous advocates of economic reform to make strong unsubstantiated claims about the negative consequences of social spending. According to many supporters of ‘hard liberal’ or ‘new right’ economic policies, high levels of welfare spending in Sri Lanka prior to 1977 were a major reason why its economy grew so slowly compared to that of other developing countries such as Malaysia. Several problems were identified in this chapter with this explanation, including the fact that Malaysia also spent heavily on social initiatives and still grew rapidly. As also shown, it is wrong to form a strong causal link between an increased rate of economic growth in the post 1977 period and the cuts to social spending that occurred in Sri Lanka. This is because virtually all the savings obtained went to fund a growing defence expenditure. While, as discussed further in chapter 8, this spending could have been better targeted, the balance of evidence also strongly supports the view that Sri Lanka’s high levels of social spending prior to 1977 had beneficial social consequences.