

PAST TRENDS AND PRESENT NEEDS IN RESEARCH ON ECONOMIC DEVELOPMENT

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The birth of many new nations in the Third World after World War II prompted many economists to focus their research on the initial stages of economic development and on preconditions for a breakthrough to a self-sustained and equitable development process. Confronted with a myriad of hitherto unencountered economic and non-economic problems, the young discipline "development economics" looked for theories which could explain the causes of economic backwardness and provide guidelines for a catch-up process. Not surprisingly, this record was moulded by the analysis of economic development in industrialized countries and by the experience of the 1930s in particular. Mercantilism, the first industrial revolution behind tariff walls, and Keynes' emphasis on demand management pointed towards governments as appropriate agents to coordinate economic interaction and provide the needed dynamic incentives.

Based on the assumption of an ideal public administration which does not pursue any specific interest but the welfare of the nation and performs its tasks without frictions, "development planning" appeared to be the means for achieving an optimal allocation of resources and a fair distribution of the benefits of economic growth (Tinbergen, 1952). Government intervention and government participation in economic activities were deemed essential to establishing an industrial base, promoting agricultural production, fixing "just" prices, and shielding the domestic economy from adverse external influences.

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The latter was a synonym for foreign direct investment and competition from abroad, in particular from industrialized countries.

The need for protection was derived from several sources. One goes back to Friedrich List's "Schutzzoll" argument which postulates that protection for domestic producers combined with internal mobility of factors of production provides the appropriate framework for industrial development and rapid economic growth (List, 1841). The other justification for protection is related to the deterioration of the Terms-of-Trade (TOT) for developing countries after the Korea boom in the 1950s. Prebisch (1959) and Singer (1964) argued that the Third World had to face a secular decline of the TOT which would inevitably reduce real income unless imports from industrialized countries were substituted by domestic production¹.

The theory of inward-oriented development planning was, however, based on several false premises. Governments and public administrations cannot be expected to be neutral arbiters of diverging claims on public support; they are rather the vanguard of the interests of some powerful social groups. The theoretically possible, pareto-optimal compensation of losers suffering from certain development strategies does not take place. It follows that government activities are not necessarily geared towards the welfare of the whole nation. Further welfare losses accrue from the inability of bureaucracies to handle complex planning systems and from short-term planning horizons. Since development planning requires targets which have to be formulated by politicians or bureaucrats, the foresight of these people is decisive for the planning horizon. Politicians tend to be concerned with imminent problems rather than with long-term development, often seeking short-term solutions to distortions at almost any cost to please the electorate.

However, even if more long-term objectives would be set by governments, the planning approach to self-sustained economic development has its shortfalls. It neglects the sociological component of economic growth which concerns motivation of individuals and incenti-

1 Protection against foreign competition became the link between "structuralists" (Rosenstein-Rodan, 1943; Nurkse, 1953; Chenery, 1955) and "dependencia" theoreticians (Frank, 1967; Sunkel, 1969). The former advocated an inward-oriented economic development on the grounds of dynamic effects accruing from learning by doing (infant industry argument). The latter postulated economic independence as a corollary to political independence to be achieved by autonomous (self-reliant) economic development.

ves to social change. When the government dictates the development path, it does not pay for individuals to be innovative and to explore new production activities or to venture into new markets; it rather pays for entrepreneurs as well as for workers to seek entry to the shelters against competition granted by the government and, then, to defend the existing economic and social structure against any change. A rent-seeking mentality of entrepreneurs and a labour aristocracy emerging from the ranks of workers tend to cement the status quo and ultimately lead to slow productivity and employment growth.

The fear of international competition inherent in the TOT argument and later in theories of unequal exchange (e.g. Emmanuel, 1972; Amin, 1975) goes back to the experience of the 1930s and the Great Depression which seemed to prove the vulnerability of countries closely integrated into the world economy. This historical perspective is excessively narrow. It ignores the opportunities an international division of labour offers to developing countries whose people are motivated to skillfully exploit comparative advantages based on factor endowments; and it disregards the fact that at an early stage of development countries lack the institutions and technologies which were available in industrialized countries in the 1930s. The necessary process of learning and institution building can be greatly accelerated by imports of capital and know-how supplementing domestic resources as has been shown by a number of countries that have actively participated in international trade and successfully attracted foreign producers².

However, most economists and most governments of developing countries considered the structural weakness of developing economies as something which can be remedied by direct intervention. This was in essence a static approach to economic development. It created several fashions depending upon which of the specific aspects of structural weakness was emphasized: import substitution was carried to an excessive stage to maintain the momentum of output growth within the confines of narrow domestic markets; regional economic integration among developing countries, i.e. among equal partners,

² It should be stressed that outward oriented development strategies were not only implemented in the much publicized "Gang of Four" in East Asia (Hong Kong, Korea, Singapore, Taiwan); such diverse countries as Brazil, Chile, Colombia, Ivory Coast and Pakistan initially joined in liberalizing their economies from the narrow limitations of domestic markets (Krueger, 1978).

was supposed to facilitate the catch-up process by pooling the resources of several countries; basic needs and integrated rural development theories suggested avenues to regionally dispersed economic and social development; and, more recently, export diversification seemed to be the clue to securing sufficient external funds for rapid economic growth.

The common misconception of all these theories is the assumption that "appropriate" government policies are sufficient for the individual pieces of the development puzzle (such as output growth, employment and income distribution) to fall into their proper places. They neglect, as in static welfare theory, that economic and social change is the precondition for development and that change takes place in a trial and error process. Neither atomistic competition nor an omnipotent administration can provide the needed incentives for individuals to depart from old habits or customs and to explore new approaches towards achieving individual or common welfare goals. Only if societies let the forces of workable competition operate freely can groups and populations preserve the momentum of change, achieve the breakthroughs at the production and technology frontier and accomplish the reorientation of social values which in combination pave the way to rapid economic and social development (Giersch, 1984).

Appropriate development theories have to center around the process of learning from past experience and maintaining an innovative spirit. We need an understanding of the framework in which forerunners such as Schumpeterian entrepreneurs set examples and followers catch up with them in a process of unbalanced growth, to use Hirschman's term. Governments have an important role to play in maintaining this process and economic policies have to be adjusted to continuously changing internal and external conditions. Development economists have, however, not reached a full understanding of the degree and direction of government intervention needed to stimulate creative destruction of obsolete behavioral patterns and economic structures. An analysis of the development performance of countries in the Third World shows that neither reliance on market forces in a given cultural environment nor state planning have been successful in providing the appropriate incentives. Yet, comparative analysis gives some clues with respect to issues which have to be looked into more closely when a dynamic theory of learning is to be elaborated.

Rapid economic development was achieved when governments were able to perceive social rigidities or emerging economic ineffi-

ciencies and take correcting action by abolishing inappropriate strategies³. Most governments of developing countries have, however, found it difficult to acknowledge mistakes and to draw the necessary conclusions. Rather, misguided policies remained untouched while new regulatory measures were imposed in an attempt to reduce the economic costs of the original policy⁴. To explain differential reactions of governments to essentially the same challenges, several hypotheses have been advanced in the literature. Many center around the cultural background of societies.

Following Max Weber (1947) some social scientists emphasize the influences of the protestant ethic and confuzianism as providing the motivation for innovative behavior of individuals under a long-term perspective of moving up in the ranks of society. By contrast, oriental, Hindu or catholic fatalism as well as tribal or feudal structures of societies tend to result in hesitant approaches to problem solution and a preference for "ad hoc" reactions to external challenges. Hayek (1979) has also shown that social institutions such as the family and private property may be essential to the emergence of a division of labour between members of a society since these institutions provide security to individuals and assure that gains from competing with others accrue to the innovator.

The importance of cultural factors for economic and social development cannot be denied. The Japanese example shows, however, that even backward feudal societies may very well accomplish the transition from isolationism with rigid social structures to an open society with social mobility without losing their cultural identity. In the case of Japan, an encrusted social order could be broken because politically influential groups actively supported social change. The-

3 Examples are the Korean drive towards heavy industries in the 1970s which was abandoned in favour of promoting skill-intensive manufacturing in the early 1980s; attempts to change industrial structures by import protection in Taiwan in 1980/81 were soon replaced by a policy of attracting new technologies via foreign direct investment; and, the modification of the administered wage increases implemented in Singapore between 1979 and 1981 which threatened to destroy the domestic industry.

4 Thus, import protection encouraged highly capital intensive investment which later had to be subsidized to survive; overvalued exchange rates led to capital controls; inflationary budget deficits to price controls; negative real rates of interest to credit rationing, artificially increased wage rates to inflated public employment; etc. The cumulation of interventions in response to mistakes largely explains the severe distortions existing in many developing countries which tend to increase rather than reduce the economic costs to be borne by the society as a whole.

refores, the influence of power structures on and the legitimacy of governments in policy formulation has to be observed more closely. It has been argued that governments (or politicians) behave rationally in a system of democratic capitalism by yielding to pressures from the electorate or, more specifically, from well-organized sections of the electorate, the so-called special interest groups, even if the resulting policy measures do not maximize national welfare (Olson, 1965; Stigler, 1971; Peltzman, 1976). How policy choices can be constrained by the influence of special interest groups has been shown with respect to economic policy-making in developed countries (e.g. economics of protection and labour legislation) but similar research in the context of developing countries is still rudimentary.

An initial suggestion that non-democratic governments (e.g. the well-meaning dictator) may have an easier stance in implementing economically optimal development strategies was valid neither on theoretical nor on empirical grounds. Many countries, e.g. in Latin America, show that even non-democratic governments must eventually seek legitimacy, either by populist appeals to the masses or by cultivating the support of important sectors such as "big business" or the military (Lovell, 1975; Becker, 1983). Hence, more research is needed which sheds light on the politicoeconomic background of economic decision-making and provides explanations as to which constellation of interest groups permitted some governments to implement appropriate policies and others not.

This type of analysis poses a number of difficult questions. The existence of interest group pressure cannot simply be proven by identifying the gainers and losers from a particular set of policy choices and imputing the outcome to successful lobbying on the part of the gainers. There may be competing pressure groups in changing coalitions, thus producing undesired side-effects of their lobbying, and second best choices may reflect some existing, irreversable market distortions rather than the influence of special interest groups. These identification problems have to be disentangled, however, if economists are to retain a meaningful role in economic policy formulation in the Third World. What is needed to break the stalemate in which many governments have manoeuvred themselves by a set of conflicting interventions is not just economically sound policy advice; it is advice on how to implement better policies in the face of mounting interest group pressure.

Summarizing, we would argue that most current theories of economic and social development assume social values and the order of societies as given. In this sense, they merely provide static approaches to development which cannot explain why some societies could organize in a more efficient way than others. A dynamic theory of development has to include a theory of learning and social choice. Economic and social progress depends upon an unhampered competition between value systems and norms from which individuals can derive the motivation to overcome obsolete behavioral patterns and to accept new challenges. Social competition takes place between organized and unorganized groups as well as between individuals and there is a tendency for powerful groups and individuals to preserve the status quo. For this reason, it is essential to analyze the conditions for maintaining the momentum of social change and the role governments can play in providing an appropriate framework for a rapid process of learning⁵.

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⁵ Work along these lines is being undertaken at the Kiel Institute. A first study on the political economy of financial liberalization in Korea has been completed (Dee, 1984), and a similar study on Mexico is under preparation.

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