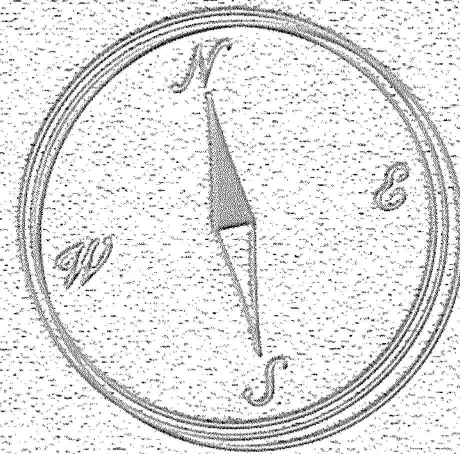
Trends in Development Assistance—Series 1

International Development Assistance: Evolution and Prospects

With specific reference to the World Bank and Japan



AKIYAMA Takamasa
AKIYAMA Suzanne
MINATO Naonobu

FASID
Foundation for Advanced Studies on International Development
International Development Research Institute (IDRI)

CHAPTER II

Evolution of Ideas on Development[12]

This chapter offers a brief review of the key thoughts regarding international economic development with particular attention to those ideas that continue to influence today's thinking. (This section should be read with reference to Figure 1.) While there is not unanimity of opinion on which ideas those are, the ones presented below are generally considered standard, though even this can vary from one development economist to another. With this caveat, there are three main stages in the evolution of development thinking; the "pioneers" (post-World War II to mid-1970s); the neoclassic resurgence (mid-1970s to late 1980s) and "new views" which emerged in the 1980s to supersede both of them. New views, as categorized here, continue to dominate today.

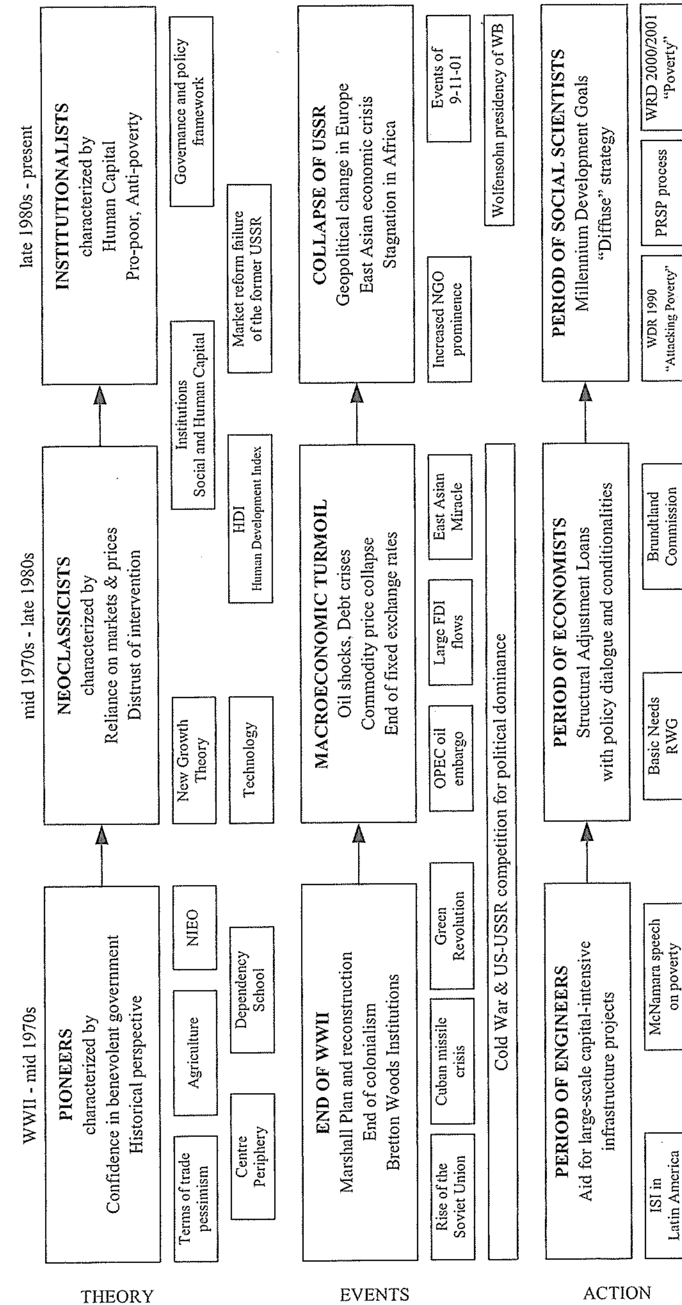
In this chapter the ideas of the pioneers and the neoclassic resurgence are presented, followed by a discussion of divergent others who were their contemporaries. Though in general the divergent others faded away, many did succeed in impacting the mainstream. As becomes clear, all these thoughts were informed by world events, prevailing political trends and, most importantly, by whether they satisfactorily explain the reality and yield policies that are perceived to work. This section concludes with an extensive look at the new views, covering the period from the early 1990s to the present.

1. The Pioneers

It is probably correct to say that the classical growth economists, Smith, Ricardo, Marx, explored the issues that lie at the core of development economics. One can easily identify economists who contributed to the study of this issue before the turn of the 20th century and into the inter-war years.

[12] This chapter draws from an extensive bibliography but has relied heavily on certain works including the following: Griffin (2000), Hayami (2001), Hayami and Ruttan (1985), Meier (various editions), Meier and Stiglitz (2001), Oman and Wignaraja (1991) and Esho (1997).

Figure 2: **The Flow of International Economic Development Assistance**



This chart is not intended to be a comprehensive depiction of development assistance over the past five decades. Rather, it is designed to capture the generalized flow of theory and action with reference to events. The large boxes give the major occurrences for each cell. The small boxes contain specifics that had or continue to have significant impact.

But development economics as a speciality concerned with improving conditions in low-income countries actually emerged in response to the urgencies of the post-World War II situation.

The first generation of development economists was at the outset rather confident (Meier, 2001b: 13). They will be referred to in this paper as the pioneers. They were macroeconomists and they focused on capital accumulation and growth rapid enough to outstrip population increase. Until the late 1960s industrialization was thought to be the primary engine of growth and the agricultural sector was seriously overlooked. Hirschman (1958), a proponent of this idea, claimed that the manufacturing industry has much more forward and backward linkages and hence more importance for economic development than agriculture. Agriculture and the natural resource sectors were viewed as sources of funds to be extracted in support of industrial development. Part of the thinking was that, after all, the difference between a developed country and a non-developed country was that one was industrialized and the other was not.

Industrialization was pursued through infrastructure development and frequently through a policy of "industrialization through import substitution" (ISI). ISI was adopted in many countries, though not always prompted by the same causes. In India, the rationale was largely ideological. There, as well as in several Sub-Saharan African countries, the model of the Soviet centrally planned economy held sway. In Latin America it was influenced by the notion argued by Argentinean economist Raul Prebisch (1950) that developing countries, so long as they specialized in production of primary commodities, would not be able to achieve economic growth because of the long-term worsening trend of commodity terms of trade against manufactured goods. However one common underlying reason for ISI was a "[r]epulsion [by leaders of newly independent states of the Third World] against the colonial system which imposed the role of the material supply base as well as the manufactured product market on them." (Hayami, 2001: 234)

The thinking among theorists was that if growth could be stimulated to reach a sufficiently high rate it would become self-sustaining, thereby lifting that country's economy out of its underdeveloped condition. The "stages of growth" theory of Walt Whitman Rostow (1960) was particularly influential to this line of thinking. Central to his theory is the "take-off" stage during which investment increases from about 5 percent of national income to about 10 percent, and productive economic activity propels an economy into "the drive to maturity" from its underdeveloped stage. The concept of the "take-off" was very appealing to providers of international economic assistance, including the United States Agency for International Development (USAID), because it foresaw a time when aid would no longer be necessary. Rostow's book is subtitled "A Non-Communist Manifesto." His theory was directed at the Soviet Union and its version of Marxism and used the experiences of countries such as the United States, Sweden and Japan for corroboration.

A theory complementary to that of Rostow was the "theory of balanced growth" proposed by Rosenstein-Rodan (1943) and Ragner Nurkse (1952). According to it, in order for developing countries to industrialize, various industries should be simultaneously promoted so they can create markets for each other. Because the domestic saving rate is typically low in these countries and because they cannot expect large foreign direct investment (FDI), they have no choice but to establish a mechanism of forced saving under government command. This view was strong within the early World Bank, where Paul Rosenstein-Rodan, held a high policy position. He was one of the first to advocate a "big push" development strategy involving government planning and major public investment. Most international assistance through the 1950s and 1960s was directed toward large-scale, capital-intensive infrastructure projects that would further industrialization and, it was thought, self-sustained growth.

During this early period, concepts and concerns were identified that have reverberated through the development literature over the succeeding decades to this day. One of these was poverty, although at that time it was not of central concern. Growth proponents believed that unequal income distribution was inevitable in the early stage of industrialization, as in the "Kuznets Curve", an inverted U shape hypothesized by Simon Kuznets (1966: ch. 4), which predicted an initial phase of increasing inequality as industrialization induced growth took hold[13]. Another legacy of this period was "policy dialogue" between aid donors and recipients, effectively the brandishing assistance as an incentive, or carrot, for fiscal or other policy changes. The practice started in this period; it re-appeared more strongly in the 1980s with policy-based structural adjustment lending; and can be seen yet today in the emphasis on correct institutions as eligibility criterion. Thus, institutions and their critical importance, so much at the forefront of international development thinking today, are also a legacy of the pioneers.

A central characteristic of this early period was a belief that government

[13] Kuznets' hypothesis has been controversial and there is not convergence of opinions on this. See Hayami (2001: Chapter 7) for discussions on economic growth and income distribution.

intervention could facilitate growth and was therefore vital to the development process. The market was distrusted. Many economists thought that market pricing posed structural problems involving imbalances of factors, and besides, memories of the Great Depression were still vivid. Exports and foreign direct investment after World War II were not thought to be growth generators[14]. Governments, on the other hand, were assumed to be benevolent and economists believed that government intervention would further the objective of economic growth (Meier, 2001: 15).

This was the prevailing view. It was not, however, the only one. Even in this early, optimistic period, a number of economists were firmly advocating a more neoclassical, market-oriented approach. One of the firmest of these was Peter Bauer. In a book written with Basil S. Yamey (Bauer and Yamey, 1968), he argued against interference with the natural flow of economic activity that he believed was based on comparative advantage. He argued against regulations, restrictions, stabilization schemes and marketing boards to control price fluctuations; and, hence, was very critical of UNCTAD (the United Nations Conference on Trade and Development). Though out of mainstream thought during this period, this line of thinking strongly affected the theories that came to dominance in the next period[15].

The generation of the pioneers tried to extrapolate economic history to the process of development, the prime example of this being Rostow's stages of growth theory (Crafts, 2001). Their attempt did not succeed and by the late 1960s and early 1970s their tenets were being overturned: The emphasis on physical capital accumulation yielded to a recognition of the importance of human capital to productivity. And, most consequentially, it was realized that the economic improvement anticipated from government planning and intervention had not materialized. Instead in many cases government failure had resulted in a worsening of economic conditions.

The "grand theory" (Leeson, 1988: 2) of economic development faded in the late 1960s. Although adherents still remained, other threads of development theory were emerging, sometimes intertwining, and being woven into the tapestry of international economic development thought. These will be reviewed below, after a discussion of the dominant group that emerged in the twilight of the government interventionists, the neoclassicists.

[14] Unlike the belief prevalent prior to World War I (Nurske, 1952; 1959).

[15] When Peter Bauer died in May, 2002, his obituary said in part [He] "challenge[d] the widely accepted orthodoxy that economic development required a pervasive role for government bolstered by official "aid". In place of corrupting "aid", he deployed the heretical idea that open markets were central to development...Yet a decade — and many billions of dollars — later, his brave stand was largely vindicated." (Financial Times, 2002a)

2. Neoclassic Resurgence

Government planning and intervention, import substitution and trade barriers, all efforts devised by the pioneers for lifting underdeveloped economies into the ranks of the developed, were ineffective. The assumptions underlying their approach came increasingly to be questioned. They came under heavy criticism in the late 1960s and early 1970s by economists who criticized the distrust of market and price mechanisms, the reliance on administrative controls and the lack of emphasis on international export competition.

A major problem with intervention, and a major contributor to its ineffectiveness, was the propensity by elites in power positions to enrich themselves and their political allies. Discretionary funding, tax revenue, and black market opportunities were all available and were all conducive to corruption and rent seeking (Krueger, 1974; Bates, 1981). Corruption, the abuse of public power for private profit, is a serious misallocation of resources that should be put to productive purpose. The widespread nature of this phenomenon prompted wary development economists to reduce the opportunities for such misallocation by turning to market mechanisms instead.

As the pioneers waned, the field of applied development economics became more quantitative and more microeconomic. Methodological explanations were found as to why the macroeconomic approach had not worked, among them the following: 1) capital accumulation was stressed rather than capital allocation; 2) inappropriate domestic policies were mistaken for adverse external conditions; and 3) the growth process was oversimplified.

This marked the stirrings of what some refer to as the "second generation" of development economists and others as the "neoclassic resurgence" (Oman and Wignaraja, 1991). These were market oriented economists for whom price was the effective tool for resource allocation and the policy objective was to "get prices right" (Leeson, 1988: 17). This implied more open trade policies as opposed to ISI. The predilection of these economists toward reliance on the market was further encouraged by the experience of the newly industrialized countries (NICs) of East Asia (i.e., the East Asian tigers) and by China's de-emphasis of central planning in favor of market forces starting in the early 1980s. This led to the theory that it was not a country's initial conditions that constrained economic progress, rather it was "wrong-headed policies" (Leeson, 1988: 14) and policy-driven distortions that were responsible for lack of economic progress.

Here the example of the Soviet Union was illustrative as it had been earlier with regard to intervention and ISI. Many of those "wrong-headed policies"

were actually attempts to replicate the Soviet state-dominated economic development model that had produced rather respectable growth records prior to the 1970s (Hayami, 2001: 132-33, 149-51; Akiyama *et al.*, 2001: 7). When the Soviet Union collapsed in the late 1980s, that model was discredited.

Instead of the closed, protective model of industrialization through import substitution, an open-economy model of development came to be favored. Government policies were still important, but economists now believed that correct government policy was market-oriented, non-interventionist, and did not create trade barriers. The now-prevailing neoclassic open-market framework prompted the Bretton Woods Institutions (World Bank and International Monetary Fund) to come up with Structural Adjustment Loans (SALs), discussed in the next section. One of their main focuses was an expansion of trade liberalization, advocated strongly by Krueger[16] (vice president of the World Bank in the mid-1980s), Bhagwati (1978) and Balassa (1978), all of whom were important influences on these organizations.

3. Criticism of and Alternatives to the Neoclassic Approach

With time, the neoclassical approach and the validity of its assumptions came to be questioned from several quarters. Criticism came from privileged and elite interest groups who favored an increased active role for government because their positions gave them access to personal benefit. But much of the doubt centered on the example of the NICs in East Asia. While market-oriented economists claimed that the "East Asian Miracle" supported their view, their opponents pointed out that neoclassical analysis could not satisfactorily explain the spectacular economic performance of the East Asian tigers. So-called "revisionists" came forward to demonstrate that the economic success of these countries not only was not attributable to markets and open trade, but in fact could be due to that very bane of the neoclassicists, government involvement. Even some committed neoclassicists who still insisted that the market was the explanation for the East Asia phenomenon wondered if it was the total explanation and could it have similar effect in other countries (Meier, 2001b: 21). Joseph Stiglitz produced an analysis that explained the phenomenon as the result of a fortuitous balance of intervention, markets and institutions (Stiglitz, 1996). The work by Douglas North on institutions has relevance here (North, 1990); in fact, the puzzle of the east Asian economies is as central to the theories of the institutionalists as to those of the neo-classicists.

During this time, there continued to be advances and nuances in development

[16] See, for example, Krueger (1978)

theory. The existence of imperfect competition, transaction costs of acquiring information and increasing returns to scale came to be recognized. New market failures were identified and analyzed. Even though correction of such failures was potentially a task for government, in the prevailing neo-classic environment, the negatives of intervention and problems with policy reform continued to militate against any suggestion that government be involved (Meier, 2001b: 21).

The clear lack of tendency toward income equality and equality in growth rates among developing countries, as was assumed under neoclassical growth theory, supported a "New Endogenous Growth Theory" (Srinivasan, 1998: 127) which appeared in the late 1980s. One of the endogenous growth factors it isolated was differences in technology, from which was extrapolated the central importance of knowledge and ideas. Knowledge is a form of capital, human capital. Although its importance had been recognized previously[17], the "new growth theory" refocused attention on the use of human capital to stimulate economic development[18].

Similarly in the area of trade, faith in free trade was overtaken by "new" trade theory that relaxed the neoclassical assumption of international trade driven by comparative advantage. For a time, the policy of strategically protecting industries held sway, encouraged by the transformation of Japan from a lagging exporter to a leading one[19]. Paul Krugman (1984) developed a variant of the strategic infant-industry protection argument which concluded that under certain circumstances, protection can actually promote exports. There were many negatives to strategic trade theory, however, including vulnerability to misuse by special interests, the fact that costs can easily exceed benefits, and the difficulty in matching assumptions and real-world situations. By the late 1980s, the strategic trade theory had lost its luster.

The dramatically sharp decline in world commodity prices between 1980 and 1993[20], and its disastrous impact on the terms of trade of the commodity exporting countries, was also problematic for neoclassic theory. Commodity price collapse seemed to confirm and revitalize the "export pessimism," theory argued at an earlier time by Prebisch (1950), Singer (1950) and Nurske (1952).

From the point-of-view of implementation, the neoclassical approach was

[17] The importance of human capital had been emphasized by a number of economists including Schultz (1964) and Denison and Chung (1976).

[18] This is a focus which continues to be very active today and is further described later in this paper. In fact, human capital is considered by some to contribute more to economic expansion than natural and physical capital combined (Griffin, 2000: 17).

[19] The Japanese experience is covered more fully in Section VI.

[20] Until recent rise, even the petroleum prices were at historically low levels in real terms.

criticized for the harshness of the SALs, which many claimed harmed the poor disproportionately. The "reformists" (discussed below) were especially critical, arguing that development should be focused on the human impact rather than on economic growth as the neoclassicists appeared to believe. Both pioneers and institutionalists criticized the neoclassical approach as disregarding reality for theory. As one observer put it "by resolutely walking away from the facts, neoclassic theory suffered a self-inflicted wound" (Hirschman, 1981: 60). Others observed that the neoclassicists' concern with "fundamentals" ignored institutions, history, and distribution of wealth, all of which were at the "the heart of development economics" (Hoff and Stiglitz, 2001: 360).

Such criticism and disagreement notwithstanding, the assumptions at the core of neoclassical, market-centered development economics continue today to be reflected in international assistance lending, particularly that by the World Bank. However, because many of the policies creating structural distortions in developing countries have been corrected, the areas for application of this approach have reduced significantly in recent years. At the same time, public attention has been drawn away from the harsher, business-like side of Bank loans toward a gentler concern with uplifting the downtrodden, toward a focus "on individuals, their crushing needs, and their soaring potential" (Einhorn 2001).

4. Others

"First generation" pioneers and "second generation" neoclassicists are useful categories for lumping development economists who subscribed essentially to the same theoretical school and accepted the same assumptions. But there have been highly influential groups and individuals out of step with the mainstream of their time whose thinking exerted significant impact on the mainstream and become increasingly relevant as mainstream theories withered for lack of effect. These economists had different perspectives which have vastly enriched the understanding of what constitutes lack of development and, to a lesser degree, what enables development.

A. Agriculture and Trade

Agriculture

The importance of agriculture to development was recognized by classical economists of the 18th and 19th centuries, including Adam Smith, Thomas Malthus, John Stuart Mill and David Ricardo. But the mainstream economists who created the field of development economics in the mid-20th century gave

it little attention. Agriculture was viewed as backward and generally overlooked in favor of industrialization until the early 1960s. Its chief interest was as a source of revenue (through taxation schemes, including commodity export taxes) to finance the urbanization and industrialization which they believed were the keys to development.

This view of agriculture as a source of input to industry is apparent in the dual economy model propounded by Arthur Lewis (1954) and the more extended and formalized version of J. Fei and G. Ranis (1964). These theories consider agricultural to be the traditional sector and a supplier of low-wage labor required for industrialization. Ricardo, an English-born Dutchman (1772-1823), had developed a model that foresaw increases in population and labor supply putting such pressure on land that increases in food prices and land rents would hinder industrialization and decreases in wage rates would result. This constraint on the economy caused by the pressure of population on land is termed "the Ricardian trap." This theory informed in that of Fei and Ranis.

Such downplaying of agriculture was despite the clear reality that in non-industrialized countries the agriculture sector was by definition the center of economic activity and the locus of employment for most of the population. A change came in 1961, when Johnston and Mellor (1961), in a landmark analysis, explored the role of the agricultural sector within the larger economy. They saw the same bottleneck that Ricardo had seen, but they also saw an unappreciated resource and suggested that in the push for development, agriculture should be attended to as a complement to industrialization not as an adversary. While they agreed that economic development would increase demand for agricultural products and that lack of agricultural supply could inhibit development, they also theorized that rising income in the rural sector could stimulate industrial expansion by supplying labor, capital, foreign exchange and food, as well as markets for domestically produced goods.

Johnston and Mellor introduced the concept of agricultural modernization through technological change which posits a theoretical escape from the pressure on land posed by the Ricardian trap (Hayami and Ruttan, 1985: 324). The benefits of technological change was supported in the Schultz-Hopper hypothesis (Schultz, 1964) which maintained that traditional agriculturalists were efficient resource allocators who were capable of recognizing and utilizing innovation that was useful. Hayami and Ruttan (1985) expanded on this by responding that innovation would not create economic return if appropriate institutional support were not present[21]. They stressed the importance of public

[21] The importance of institutions to development is a theme that has waxed and waned over the years and is today very much at the forefront, as is more thoroughly discussed later in the paper.

agricultural research and experiment systems appropriate to the environment of the developing countries.

One stellar example of technological innovation was the "green revolution," which is the term applied to the discovery by an international research institute in the 1960s of successful methods for dramatically increasing agricultural output, through high yielding varieties and through carefully managed application of inputs. Eventually the "green revolution" process came under criticism for several reasons. Its technologies work only under certain conditions so that many farmers in many parts of the world reap no benefit. Sub-Saharan Africa, for example, has seen little benefit[22]. Some argue that the breakthroughs favor larger, more capital intensive farms over smaller, more labor intensive ones, although Hayami and Ruttan (1985) rebut these charges. Criticism has also been aimed at the negative environmental effects of the chemical inputs required[23].

Through the work of these and other agricultural economists the sector gained prominence during the neoclassical resurgence. Many of the SALs which were the hallmark of that period carried conditionalities directed at structural adjustment of agricultural sectors. This was especially so for Sub-Saharan Africa, the least industrialized and most agriculturally dependent region. More recently, when the World Bank shifted its development strategy to emphasize poverty reduction, the sector attracted renewed attention because of the fact that the majority of the poor live in the rural sector[24]. The World Bank estimated in 1984 that of 800 million people living in absolute poverty in the less-developed countries, 640 million (some 80%) were rural[25].

Despite this interest and awareness, the resource that Johnston and Mellor had recognized continued to be underutilized. Many rural poor remained underemployed and unable to contribute economically. The considerable consumer demand they represented continued to be unrealized. Instead, they were a drag on the industrialized sectors for which they should have been supplying food. At the same time, they continued to produce the primary commodities that were the economic bedrock for most developing countries and a source of vital foreign exchange and tax revenue.

[22] In early 2001, the creation of a strain of rice called NERICA (New Rice for Africa) was announced by the West Africa Rice Development Association, a research center connected with the World Bank coordinated Consultative Group on International Agricultural Research (CGIAR). http://www.cgiar.org/index.html

[23] The environmental ramifications of many aspects of development efforts are a continual magnet for criticism and controversy.

[24] However, as is noted later, this renewed interest in the poverty of agriculture did not translate into increased lending.

[25] Recent Bank estimate is 70% (World Bank, 1997c).

Structuralism and Dependency

Structural analysis, or "structuralism," attempts to identify rigidities or other structural limitations in an economy that impede the changes that development policy measures are meant to bring about. It has been applied to various countries in various regions of the world, but the Latin American version is the most notable, primarily for historical reasons. Historically Latin America was highly dependent economically on the export of primary commodities and has experienced unstable growth[26]. This instability was due to low price elasticity of demand and fluctuating production as well as to world events such as the two World Wars and the Great Depression. Because of the low income elasticity of demand for their products, they also faced low demand growth.

But there is another reason why Latin America is closely associated with structuralism, the work of Argentinean economist Raul Prebisch who is mentioned above in connection with "export pessimism." He was an early Latin American structuralist whose analytical work and position at the UN Economic Commission for Latin America (ECLA) is largely responsible for the prominence of this concept. He perceived declining terms of trade for primary commodities and argued that industrialization was required for economic development. In 1950 he became Executive Secretary of ECLA and led its economists in wrestling with actions that would accomplish this.

They put forward the "center-periphery" concept. It stipulated a world economy in which peripheral sectors characterized by low income co-exist in an economic system with central sectors characterized by high income. The periphery's products are agricultural and primary commodities, undifferentiated goods subject to market competition. The center, on the other hand, produces industrial goods that can be differentiated and therefore marketed monopolistically. These differences result in worsening terms of trade and external deficits for the periphery and consequent structural unemployment. The dominant center is able to maintain its relative advantage so that the benefits of industrialization remain out of reach of the periphery. According to this scenario, persistent underdevelopment is a structural condition in the periphery resulting from its interaction with the center. The periphery requires protection because of its lower industrial productivity levels relative to those of the center.

To provide this protection and counteract the structural disadvantage of the periphery, the ECLA economists endorsed ISI, discussed above, and argued that the main policy instruments should be high tariffs for industrialized goods and "industrial programming." "Industrial programming" was an approach

[26] Even today, Latin America seems to be struggling with this problem (Hausmann and Gavin, 1995).

constructed around investment planning and coordination. Effectively this was state intervention through investment planning. ECLA economists also were opposed to anti-inflationary advice and conditionalities imposed by the IMF because they believed that strict monetary policy sacrificed growth in favor of stability, a trade-off they did not like. Their willingness to accept monetary expansion and associated inflation as a price of structural change was a defining characteristic of the Latin American structuralists.

This orientation, inward-looking and conducive to severe inflation, could not stand up to the macroeconomic dislocations of the late 1970s and 1980s, including oil shocks and debt crisis. The impact of hyper-inflation and external debts on the Latin American economies was so severe that the 1980s are sometimes referred to as "the lost decade." Eventually Chile broke with the structuralist approach and accepted the neoclassicist approach under technocrats called "Chicago boys[27]." Soon, other countries followed, signaling the end of structuralism.

Dependency theory is closely related to structuralism and emerged somewhat as a reaction to perceived limitations of the Latin American structuralists. Like structuralism, dependency theory assumed a center and a periphery, but unlike the structuralists, dependency theorists characterized interaction between them in terms of power rather than trade. They were attuned more to ideological than to economic facts, paying explicit attention to the political economy effects of capitalist development on the periphery. This approach is associated most commonly with Fernando Henrique Cardoso[28], a Brazilian sociologist whose work dates from the mid-1960s[29]. Many dependency theorists were sociologists and political scientists and their theories had serious political, even ideological, overtones. They had strong elements of the Marxian theory of capitalism. Some of their solutions required transformation of international economic interaction; others advocated a "de-linking" from the international system.

As with structuralism, there are variations to dependency theory and applications to other geographic regions. German born Andre Gunder Frank (1969) became a well-known proponent, due perhaps to the access to Latin American debate he provided through his English writings on the subject. Frank believed that underdevelopment in the periphery was consequent to a hierarchical chain of metropoles and satellites created by capitalism, each level

[27] The name derives from the fact that many of them were graduates of University of Chicago.
[28] Mr. Cardoso was president of Brazil from 1995 until October 2002.
[29] See, for example, Cardoso (1977).

extracting surpluses from the one below. From this he hypothesized that the "development of underdevelopment" was inevitable within the capitalist system. This thesis was explored also by Theotonio dos Santos, the Brazilian theoretician who provided the most widely quoted definition of dependence: "Dependence is a conditioning situation in which the economies of one group of countries are conditioned by the development and expansion of others...when some countries can expand through self-impulsion while others, being in a dependent position, can only expand as a reflection of the dominant countries, which may have positive or negative effects on their immediate development" (dos Santos, 1970: 289-290).

An even more radical view was held by a Marxist Paul Baran, one of the earliest and most influential dependency theorists. He believed that dominant interests in advanced countries were actually aware of, threatened by and adverse to the potential for economic development in underdeveloped countries (Baran, 1957). Historically, colonies were in the weak, dependent periphery and imperial powers were in the dominant center, later this was applied to the developed west (north) as dominant and the undeveloped south as dependent.

Because of the power relationship between the dominant and the dependent, dependency theorists did not accept the concept of "modernization," that development would spread from developed countries to the underdeveloped. In fact, their belief was that the constraints on development in the periphery were more accurately explained by the role of pheripheral countries in the international capitalist system rather than by their domestic situation. The concerns of the center-peripheral and dependency theorists can be heard today in the vehement opposition to "globalization."

New International Economic Order

Concurrent with the neoclassicist thread with its distrust of government involvement and its efforts at structural reform, the proponents of structuralism and dependency were creating a countervailing movement. Advocates of managed primary commodity markets were organizing to promote serious government intervention. These were the low-income countries themselves who were influenced by "pessimism" theories regarding deterioration of terms of trade for less developed countries (LDCs) (Prebisch, 1950 and Singer, 1950). At a summit meeting of non-aligned nations in Algiers in1973 they initiated a political drive to improve their conditions under the rubric "The New International Economic Order" (NIEO). The measures they proposed included establishment of international buffer stocks, the creation of a common fund for

commodities to finance those stocks, multilateral trade commitments, and compensatory financing to stabilize export earnings. The NIEO was designed to counter the long-term declining terms of trade predicated by the structuralists. The intention of the low-income countries (the "south") was to act jointly as a power block to insist on international measures that would favor their economies, for the most part primary commodity based.

The NIEO that took form in the early 1970s was actually a coalescence of the ideas and campaigns of Raul Prebisch, who became the first Secretary-General of UNCTAD in 1964 after leaving ECLA. He was a driving force behind its formation and a main factor in turning it into a standing organization rather than a one-time event[30]. Many, though not all, of the NIEO concepts were brought by Prebish to UNCTAD and the international trading arena from ECLA. Through the 1950s and the 1960s he had developed theories and a program based on them which were influential among Latin American governments[31]. These theories, modified by political constraints and the lessons of experience, were transformed into the New International Economic Order.

The NIEO was formalized by UN resolution at a special General Assembly session in spring 1974. Three separate resolutions were adopted, one of which was the Declaration on the Establishment of a New International Economic Order[32]. UNCTAD, a unit set up by the UN to help developing countries by exploiting the link between trade and development, adopted the NIEO at its fourth conference (UNCTAD IV) in Nairobi in 1976 and established the bureaucratic machinery for implementing an integrated program for commodities. The community of development economists was from the outset unenthusiastic about the NIEO. In addition, it became clear that the eventual costs would be prohibitive. For these reasons, and because of divergent interests among the countries in the "south," the NIEO withered away. The Common Fund for Commodities headquartered today in Amsterdam is a truncation of NIEO[33]. The NIEO concept currently only lingers in such milieu as commodity organizations[34].

[30] Mr. Prebish left UNCTAD in 1968, he died in 1986.

[31] In the 1960s he recruited top economists Alfred Maizels of Britain and Jan Tinbergen (future Nobel Laureate) of the Netherlands to work on commodity agreements, starting with a buffer stock agreement for cocoa (Love, 2001).

[32] Yugoslavia, Algeria, India and Iran drafted a position paper for the special session which effectively became the NIEO resolutions (Johnson, 1987)

[33] It was established in 1980 to finance the projected Integrated Program for Commodities. It came into force in 1989 but was never put to the purpose intended. Its focus remains on commodities and currently it provides funding for research and project work on a commodity rather than country basis. At this time its declared aim is to assist developing countries and countries in transition transform from regulated to liberalized market systems and participate in the global economy. Another aim is to address market failures.

[34] The recent (failed) attempt by the Association of Coffee Producing Countries (ACPC) to institute a retention scheme is one example.

B. Reformist/Basic Needs

Working alongside the mainstream economists, both the pioneers and the neoclassicists, there were analysts who were uncomfortable with development orientations overly focused on growth. Growth-oriented theories posited a "trickle down" effect by which the poor would be lifted out of poverty as a by-product of growth. But some observers noted that in spite of high growth in the period of the 1960s, the first UN Development Decade, "trickle-down" was unsatisfactory. To this group this meant that emphasis on growth was missing the point. Gunnar Myrdal (1956: 47-51), who shared with Prebisch and Singer a pessimism about the impact of market forces on equality, devised a world anti-poverty program that emphasized equality rather than growth as a goal (Myrdal, 1970). A 1969 speech by Dudley Seers, a Cambridge development theorist, sums up the concern:

> *The questions to ask about a country's development are therefore: What has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have become less severe, then beyond a doubt this has been a period of development for the country concerned. If one or two of these central problems have been growing worse, and especially if all three have, it would be strange to call the result "development," even if per capita income had soared* (Seers, 1969).

This view shifted and broadened in perspective from a concern with inequality among countries to encompass inequality among people within countries as well. Framed this way, the problem took on dimensions that it had previously lacked but which have remained and are very much in the forefront today. The economic impact of environment, education, employment, health and inequality came to be integrated in this concept. This attention to living conditions as opposed to growth generated three directions of thought: 1) an attempt to improve standards of living in the absence of an enlarged economic pie, the "Basic Needs" approach; 2) a reinvigorated emphasis on institutions and social capital; and, 3) attention to the role of human capital in the development process. "Basic Needs" is considered here. The other two directions are presented in the "New Views" sub-section below.

The underlying hypothesis of the "Basic Needs" campaign was that a high level of basic needs can be satisfied at a relatively low level of per capita income. The term was first mentioned in the early 1970s and gained prominence

as part of an International Labor Organization (ILO) proposal in 1976. It became best known when Robert McNamara adopted it as a World Bank strategy in the 1970s. "Basic Needs" was defined as two elements: 1) the minimum requirement of a family for its own consumption, including but not limited to food, clothing and shelter; and 2) essential services provided by and for the community, including drinking water, sanitation education, and health facilities. Satisfying this would require significant government involvement and was compatible with the prevailing emphasis on the role of the state as a provider of services to improve the conditions of the people. The experiences of several countries were cited as support, but the Chinese economic experience under Mao-tse Tung is thought by some to have been the most influential.

This concept helped bring international attention to the issue of poverty and served to encourage important research on it. The World Bank was at this time embracing poverty reduction as a strategic objective, it did not really pick up the "Basic Needs" concept until the late 1970s. Its initial program response to the interest drawn by "Basic Needs" was the introduction in 1974 of an income enhancement program called "redistribution with growth" (RWG). Unlike "Basic Needs" which was consumption based, RWG was an incremental program whose results were gradually to be felt over time. It was intended to attack poverty and encourage development through integrated urban/rural projects, but the associated complexity produced disappointing results. Spurred by the resultant criticism, the Bank turned to the "Basic Needs" approach which was more direct and was thought to be quicker and more efficient than income enhancement.

The World Bank's stated aim became "to increase and redistribute production so as to eradicate deprivation that arises from a lack of basic goods and services...The demand now is to put man and his needs at the center of development" (Streeten and Burki, 1978: 411). Under "Basic Needs", as with RWG, the World Bank effort continued toward integrating rural and urban development programs. However, as with RWG these programs were complicated, involving various segments of the government and having multiple objectives[35]. As with RWG they were not very effective. As will be explained, the intent to alleviate deprivation that drove these programs is once again being again proclaimed by the Bank. Achieving it at that earlier stage could not be successful. Research was carried out in 1978-80 on strategic design but it seems that the Bank was not able to fully come to grips with implementation before the tide turned.

[35] Often called "Christmas tree" projects.

By the early 1980s, the concept was fading. Among those who supported it, fundamental differences appeared as to the preferred definition of basic goods and how the program should be applied in the urban and rural sectors. Among those who did not support it, strong criticism was voiced, such as this accusation by A. de Janvry, "The basic needs approach...has absolutely no theoretical foundation" (de Janvry, 1981: 258). At this time also, specific problems were being identified: The institutional context was inadequate, a problem common to approaches requiring government involvement. It was excessively oriented toward agriculture yet failed to achieve a reliable food surplus. Beyond this, deeper analysis was confirming serious theoretical problems; for example, that improvements in domestic terms of trade could benefit the poor more effectively than could direct consumption intervention (Oman and Wignaraja, 1991: 115-120).

5. New Views

When the optimism of the pioneers failed to be justified and the assumptions of the neoclassicists lost credibility, concepts that had been hovering around the edges of development economics began to move to center stage. Institutions, long recognized as significant but never really spotlighted, and human development, advocated by "reformists" as an alternative to growth as the objective, emerged as hitherto under-appreciated, fundamental elements of the development process. Approaches built on these foundations gained credence and continue to resonate strongly in the field of international assistance, both theory and practice.

A. Institutions and Social Capital

Analogous to the pioneers' assumption that the difference between developed economies and non-developed economies was the presence or absence of industrialization, there are those in the very forefront of development thinking who postulate that the difference lies in the presence or absence of salutary institutions. This line of thinking is very forceful today, as will be seen in later chapters.

Reference to institutions, to the importance of institutions, and to obstacles posed by unsuitable institutions is scattered throughout the history of development economic thought. Perhaps one of the earliest modern references is in the book *The Protestant Ethic and the Spirit of Capitalism* written by Max Weber and published in 1905. Agriculturalists referenced institutions in the context of technological innovation (Hayami and Ruttan, 1985). The

pioneers did so in the context of government planning. The neoclassicists did in the context of government interference. Institutions are the very core issue for the reformists, with their emphasis on education, health, employment and equity. And the failure of the "Basic Needs" campaign of the 1970s was been largely attributed to institutional inadequacy.

Over the course of fifty years, as theory yielded to new theory and practical applications disappointed, one after another, the realization took hold that perhaps institutions were of an even higher order of importance than had been thought. Perhaps, it came to be thought, underdevelopment is institutional failure. There are a number of prominent economists who contributed to this new paradigm, including Akerlof (1984), Coase (1937, 1960), North (1990), Olson (1965), Stiglitz (1989) and Williamson (1975, 1985). The success of the East Asian economic miracle, mentioned above in the context of neoclassicism, prompted economists to examine whether the institutions characteristic of that region — trust, cooperative attitudes among economic agents and effective judiciary systems — were elements key to its economic growth[36]. This possibility was re-enforced by events in an entirely different region, the former Soviet Union. When a coordinated, "big bang," attempt was made to introduce a market structure into those transitional economies, it failed spectacularly[37]. An analysis of the collapse clearly revealed that a lack of institutional support was the culprit. "The experience of transition, especially in the countries of the former Soviet Union, vividly illustrates that market reforms in the absence of effective domestic institutions can fail to deliver growth and poverty reduction" (World Bank, 2001e: 32).

A look at any dictionary will reveal multiple definitions for the word 'institution.' For development economists, however, the most influential definition is that of Douglas C. North: Institutions are "the rules of the game" (North, 1990: 1). "Game" here is far-reaching but basically means written laws and unwritten conventions sanctioned by members of society. Institutions can include organizational rules, formal laws, and informal norms. This definition is supple enough to encompass constructive rules, destructive rules and no rules at all.

Subsumed within institutions is the concept of social capital. Social capital has been defined as the coherence of a society's values and the capacity they afford for mutually beneficial interaction (Collier, 1998: 3). Trust, cooperation,

[36] See, for example, papers in Hayami and Aoki (1998) and Stiglitz (1996).

[37] In Russia this tactic was called "shock therapy" and was largely co-ordinated by Jeffrey Sachs, at that time Director of the Center for International Development at Harvard University. From December 1991 until January 1994 he served as advisor to the Russian government on privatization of the economy.

coordination and reciprocity are examples of civil social capital, as are norms, informational networks and social sanctions (Hayami, 2001: 288-291). Civil rights and good governance are examples of government social capital. Social capital can augment the positive effects of both human capital and physical capital, increasing their return[38].

Capital is an economic input whose application increases value. Orthodox economics traditionally ascribe the term "capital" to tangibles. There has, however, been a growing awareness that some intangibles can create value and contribute to economic growth. They have come to be called "social capital" and "human capital." (Human capital is discussed in the following sub-section.) Some economists quarrel with the idea of social capital; firstly, because it is not capital in a true economic sense; and secondly, because it is defined in such a way that a negative effect on development can be assumed as readily as a positive one (Arrow, 2000: 3). There is no question, however, that the ideas of social capital, institutions and culture interact and overlap. Cultural values can be elements of social capital and North believes that cultural beliefs are a basic determinant of institutional structure (North, 1990). According to Landes (1998: 516-17), "If we learn anything from the history of economic development, it is that culture makes all the difference." A similar note is sounded by Meier (1995: 83). To fully comprehend institutions, then, it may be necessary to go beyond economics to an interdisciplinary approach involving anthropologists, historians, political scientists, psychologists and sociologists. As will be described below, the World Bank has adjusted its staff composition so that now a significant percentage has social science expertise.

These concepts and theories opened a new way of perceiving, examining and understanding economic development issues but their actual application to development assistance is almost by definition not an easy task. What can be derived is that institutions and social capital are primary elements underlying economic development. This, in turn, suggests that development assistance should focus on inducing and strengthening institutions and, hence, on increasing social capital. As for policies, they should be modified to encourage appropriate technical and institutional innovation (Hayami and Ruttan, 1985: 416). How to translate this into projects on-the-ground is a paramount question and unfortunately this question has not been satisfactorily answered. Promoting changes in laws and regulations and in government bureaucratic structure are some of the possibilities. This path, however, risks being construed as too

[38] It can also do the reverse, and Collier recommends promoting those aspects which are most progressive and rectifying those that are regressive (Collier, 1998: 31).

intrusive and interventionist in the domestic political structure of developing countries.

An avenue perhaps even more promising leads in the direction of rural organizations, such as cooperatives. Based on his extensive field work, and extending the analytical framework of institutions and social capital, Hayami (2001: Chap. 9) considers that communities, especially those in the rural areas, could play an important role in economic development. This resonates with the notion of Binswanger and Deininger (1997) that farmers need to organize to acquire the political power to influence policies. Some development organizations, including the World Bank, were reluctant to accept this because of failed attempts in the 1960s and 1970s to support cooperatives in Africa. However this approach regained credibility[39] with the recognition that the past failures were due to the fact that most cooperatives in Africa had been established for political purposes or to strengthen government marketing boards and were not true "cooperatives."

Despite such uncertainty about operations, the primacy of institutions, established theoretically in research dating back several decades, is currently widely accepted within the development assistance community. Extensive analysis is on-going to find effective, practicable ways of transforming unsuitable institutions so that aid can work. More on this topic is presented below.

B. Human Development/Human Capital

In the view of its proponents, human development is the ultimate objective of economic development as well as "the best means available – for promoting development" (Griffin and McKinley, 1992). Human development advocates believe that human development not economic growth should be the objective of economic development and that increasing human capital is a better way to achieve development than increasing physical capital. Because of this conviction they have been keenly interested in broadening economic development indicators beyond the commonly used per capita measurements of growth.

One of the first such systems was developed in 1970 by the United Nations Research Institute for Social Development (UNRISD)[40]. Another was developed by Morris D. Morris (1979). It was called the Physical Quality of Life Index (PQLI) and was based on three indicators: life expectancy at age one year, infant mortality and literacy. These did not gain wide currency but they presaged the creation in the late 1980s of a system that did, the Human Development Index (HDI). This was developed under the auspices of the United Nations Development Programme (UNDP)[41] by Mahbub ul Haq (considered the architect of the HDI) in collaboration with Amartya Sen and Meghnad Desai. It has four components:

- life expectancy at birth,
- adult literacy rate,
- combined enrolment rate in primary, secondary and higher education, and
- real income measured in purchasing power parity.

The HDI has become a widely accepted and respected indicator. It is very influential because it provides a previously lacking measurement tool needed by non-orthodox development theorists if they are to assert legitimacy. The HDI epitomizes the human development approach and because it assesses factors that fall within today's definition of institutions, it adds weight to the argument that institutions are profoundly fundamental.

Human development was a new ingredient in development policy prior to 1980 as a component of "Basic Needs" and it re-emerged after 1990 with the publication of the World Bank *World Development Report* of 1990 subtitled "Poverty" (World Bank, 1990). During the decade of the 1980s, reformist proponents who insisted on looking differently at the issue of underdevelopment, such as Seers (1983) and Streeten (1995), were forced to yield before the hard reality of international macroeconomic crises. The neoclassical resurgence shouldered reformism out of the economic arena and into the sphere of other organizations, notably those within the United Nations family such as the United Nations Development Programme (UNDP).

Although the pre-1980 effort by reformists to move human development into the mainstream of economic analysis was stymied, it did have important repercussions: It generated much discussion. In highlighting poverty rather than growth as the essence of underdevelopment, it laid groundwork for later attention to that issue. And it directed attention to an examination of the significance of human capital. Human development enhances the health,

[39] The community-driven development (CDD) approach, which became one of the Bank's main project types since around 2000, is an application of this strategy.

[40] Established in 1963, headquartered in Geneva, Switzerland, UNSRID is an autonomous United Nations agency that carries out research on the social dimensions of contemporary problems affecting development. http://www.unrisd.org/

[41] Beginning with the first issue in 1990, it has been a part of the annual UNDP Human Development Report.

education, skills, and other capabilities of people, thereby by increasing human capital.

The importance of human capital received strong theoretical support from the "New Endogenous Growth Theory" mentioned above in the context of alternatives to neoclassicism. According to this theory growth can come from within a system (endogenously) when economic activity creates new knowledge; thus, production functions would have increasing returns because of specialization and investments in knowledge capital. (Romer, 1986, 1990, Lucas, 1988). The key to this process is a cumulative magnifier effect of new knowledge; it does not stay within the confines of the firm that creates or exploits it but ripples through the economy so that the efficiency of labor of a firm does not depend only on that firm's investment but on the knowledge produced from the investment of all firms (Hayami, 2000: 171-2). This emphasizes the contribution to economic growth of knowledge-producing, human capital-intensive sectors.

Amartya Sen influenced this thinking by contributing the concept of capability to function. He continued the line of economists (discussed above as "Reformists") who saw development in terms of quality of life rather than quantity of growth. Sen used the term "deprivation," a lack of access to entitled capabilities which he described in the following words: "...what he can or cannot do, can or cannot be" (Sen, 1995: 11). A genuine capability to function—to choose and to react—is necessary to quality of human life and hence to absence of deprivation. Imposed benefit or benefit offered without alternative is not acceptable because there is no capability to function. Deprivation is not relative, it is absolute. Sen's entitled capabilities include nourishment, shelter, community life, freedom to travel and freedom to associate and are clearly a legacy of the "Basic Needs" idea. When asked to characterize a successful economy, he told an interviewer, "This concerns how the worst-off members of society share in that society. Neglect of people at the bottom of the ladder would indicate a failed economy" (Longworth, 1999).

The complexity and interrelatedness of development constituents is very apparent here. Education is a key to capability because it is an entree to empowerment, the ability of people to influence forces that affect them. There is clear linkage here to the "empowerment" component of current poverty reduction strategy, as discussed below[42]. There is also relevance to institutions as often the forces that affect people are "the rules of the game." Sen looked closely at what creates social convention and has analyzed how the preferences of society as a whole relate to the values of individuals. One of his conclusions is that for capability to function to be realized, an environment of freedom, allowing free choice, is essential. For this reason he has equated development with freedom (Sen, 2001: 506).

These concepts have enormous currency today. Within the community of international organizations, after the hiatus of the 1980s, the concept of human development reappeared with considerable momentum. It has been adopted by the World Bank and now figures prominently among its assistance objectives.

[42] Appendix 2 and Box 5 in Chapter IV present an array of "Elements of Development" and deal further with the interrelated complexity of the constituents of economic development.