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Economic Development in Latin America and the Methodenstreit: Lessons from History of Thought

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Abstract: Latin America has experimented with two development strategies over the last two centuries. The first is "outward-oriented" development based on exports of primary commodities, while the second relies on domestic industrialization from within. A consensus that both models failed to achieve sustainable development in Latin America opened space for rethinking development theory and policy at the beginning of twenty-first century. Nevertheless, the debate lacks the understanding that history is non-linear, which explains why peripheral countries are emulating core countries to promote development. This paper argues that the recurrent inadequacy of development theory is due in part to the dichotomy between history and economics that emerged with the *Methodenstreit* — a debate about what method was most adequate to undertake social analyses. Development theory presupposes historical specificity, its *raison d'etre* being the belief that underdeveloped economies function differently than their developed counterparts. A meaningful theory of development relies on a shift from abstractions based on human nature to historically grounded principles.

Keywords: development theory, history of economic thought, *Methodenstreit*

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Development economics confronts the fact that there is poverty, illiteracy, inequality, and violence in the world. The search for ways by which countries might transcend these circumstances has engendered diverse doctrines and great controversy. Concerns of national development are, of course, closely related with the problems first broached by the classical political economists. Nevertheless, development economics became a matter of international interest only in the 1950s (Dulles 1956, 124-125), becoming established as a sub-discipline at the beginning of the Cold War era.

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For a large part of the past two centuries, peripheral countries were persuaded to follow an outward-oriented model of development based on free trade and the exportation of primary commodities. Underpinning these models are universal economic theories, intellectually crafted in the research centers of the hegemonic powers. In nineteenth-century Great Britain, classical political economists, searching for universal truths behind capitalist social and institutional changes, assumed a fixed human nature and, on this basis, naturalized market relations. The benefits of a competitive market and its self-regulating forces acquired the irresistible impetus of natural laws. Pro-market policies, in turn, were prescribed worldwide. Although in the twentieth century the theoretical foundation for pro-market policies had mutated,[1] the universalist assumption of fixed human behavior and laws of economic development were maintained. Borrowing from the laws of physics and applying sophisticated mathematical models, neoclassical economists proclaimed the universality of self-equilibrating market forces (Mirowski 1988, 6).

Draped under a cloak of scientific neutrality, "cosmopolitical" economists have designed policy on a "one-size-fits-all" basis, overlooking the specificities of institutions, histories, and cultures.[2] Friedrich List (1856), one of the first proponents of the German historical school,[3] denounced the classical political economists' claim of the universal benefits of free trade as a strategy to support Britain's hegemonic power. While Adam Smith's economic principles were appropriate to understand a relatively developed and dominant economy such as Great Britain, they could not grapple with a nation in its earlier stages of industrial and political development such as Germany (Hodgson 2001, 61). A hundred years later, just like the German historical school before them, Latin American structuralists and *dependentistas* believed that historical specificities were critical to understanding peripheral economies, and they supported the creation of new economic theories, or the modification of existing ones, to apply them to a development setting.

The consolidation of development theory in the post-World War II period relied on the belief that underdeveloped countries worked differently and had different political needs than developed ones. In that sense, development theory presupposes historical specificity, its *raison d'etre* being the belief that underdeveloped economies function differently than their developed counterparts. A debate centered on the issue of specificity *versus* universality of economic assumptions — reminiscent of the *Methodenstreit* many years earlier — lasted from the 1950s to the 1970s. Despite the efforts of those holding a number of competing theories (Marxists and structuralists, among others), outward-oriented development strategies were revived by neoliberal economists in the 1970s. Given this background, it seems appropriate to raise a few questions. Why were alternative models and policies so short-lived? What were the forces determining their emergence and demise? Was the demise due to the quality of the theory or to politics?

Of course, these are not mutually exclusive questions. This paper, however, focuses on the role of theoretical weaknesses.[4] My main argument is that the failure to push forward a new agenda occurs because development theories lacks, to a greater or lesser extent, an understanding of history as a non-linear process, meaning that the economy does not consist of a homogeneous reality, evolving linearly from primitive societies to market economies (Braudel 1979, 23). According to Fernand Braudel, historical reality is structured with economic relations forming only one of many social layers. The evolution of these layers may rival, assist, and at times contradict one another.[5]

On the other hand, if history is governed by natural laws, it unfolds teleologically with human subjects impotent to change its course. Although mainstream economists hold that economics is about choices, their model specification leaves no room for genuine human choice. In fact, agents are considered to make economic decisions based on rational choice with the models implying there is only one way of behaving rationally given individual preferences and endowments. In sum, human choice is ultimately denied in mainstream models (Lawson 1997, 8-9).

A theory that emphasizes the linear viewpoint focuses on the commonalities among different economic systems and tends to underestimate the conflicts and complexities involved in the process of development. Failure to capture the complexity entailed in social change allows economists to prescribe policies based on simplified models to achieve economic prosperity. Adopting a linear perspective of history, most development theories continue to argue that peripheral countries should emulate core countries and see development policy as a way of speeding up the process. Although societies move at different paces, they ultimately travel toward the same destination. Despite differences of culture or history, they eventually converge to a common form: namely, that of U.S. liberal capitalism (Latham 2011, 3).

My argument is set out in three sections. The first section discusses the *Methodenstreit*, focusing on the compatibility between historical specificities and general theories. By addressing this debate on economic methodology, I intend to show that the recurrent inadequacies of development theory are due to the dichotomy between history and economic theory that emerged with the *Methodenstreit*. The second section presents various theoretical attempts to include historically grounded assumptions as a way of formulating economic theory, and the neoclassical response to them. During the *Methodenstreit*, neoclassical economists defined the core of their theory in terms of general laws of human nature. From this point onwards, historical and socially specific content does not enter the core of economic theory, but may orbit around the core in a subsidiary position. Development economics, as I will argue, is not an exception to this rule. A third section looks at different development theories from the 1950s and 1960s, where the focus is on the perspectives of development theorists regarding the role of history in economics. Finally, I contend that, by the mid-1960s, some Latin American scholars had taken preliminary steps towards a history-oriented development theory. Due to the early demise of alternative theories of development, however, an adequate response was never formulated.

History and Economics: Two Separate Sciences

The Forerunners

Development theory presupposes historical specificity. Its *raison d'etre* is founded on the belief that underdeveloped economies function differently than their developed counterparts. Given the importance of historical specificities for understanding the way capitalism spreads through peripheral countries, development theoreticians have frequently inquired whether or not a universal or "one-size-fits-all" model applies to peripheral economies. Should economists abandon theories formulated for advanced capitalist countries and "go native" in their search for development or should they choose some middle ground?

This question has its roots in the nineteenth century. In fact, it originates with the issue of whether economics is a nomothetic (dealing with absolute or universal statements) or an idiographic science (dealing with the concrete or unique). This inquiry was at the center of the *Methodenstreit* in the second half of the nineteenth century. The *Methodenstreit* undergirded and divided all of modern social science between idiographic humanism and nomothetic sciences. In economics, the debate lasted around fifty years and was ultimately resolved with the consolidation of the marginalist school of thought.

Political economy had long considered itself a nomothetic science in the sense that it sought to develop models of universal applicability and laws of universal efficacy. Influenced by Enlightenment philosophy, Adam Smith, David Ricardo, and Jeremy Bentham searched for objective knowledge and universal truth, upholding the view that human nature was fixed and universal. History was seen as a linear process through which capitalist relations evolved naturally from human nature. Previous economic systems were mere steps towards the development of capitalist institutions.

For instance, Smith's ([1776] 1976, 25) assertion that "[t]he division of labour arises from a propensity in human nature to … truck, barter and exchange one thing for another" which "is common to all men" implies that exchange in pre-capitalist societies was equivalent to exchange in capitalism. Regarding assumptions about human nature, classical political economists "bore all too lightly the burden of primitive man" (Pearson 2000, 933). Hunters, gatherers, and nomads were not completely forgotten by political economy, but their inclusion was *ad hoc* and not grounded on any established empirical record. Rarely did economists venture beyond the "four-stages theory" of economic development proposed by Adam Smith and others (Meek 1971). Heath Pearson (2000) argues that, until 1859, most scholars accepted the universality of *homo economicus.*[6]

David Ricardo took capitalism for granted. His ahistoricism implied that capitalist social relations are a natural, ineluctable realization of human nature.

Therefore, he saw all previous history as simply the purposive development of capitalist institutions (Hunt 1984, 104). The drive for a competitive market economy was believed, consciously or not, to follow from the inexorable laws of nature (Polanyi 1944 [2001], 134).

Remarkably, the classical-political-economy assumptions about human nature and the conception of market relations as natural still pervade modern mainstream economic thought, which presents society as a collection of ahistorical individuals (Hunt 1984, 122). In fact, neoclassical economists insist on abstracting economics from all social relations and institutional arrangements.[7] For Carl Menger (1883), institutions are reducible to mere consequences of individual behavior. Ultimately, no force beyond the control of the individual determines human behavior. As capitalism is natural and universal, a general theory provides "one-size-fits-all" solutions for economic prosperity at any point in time and space. The real history of socio-economic systems is lost.

The role of historical specificity in economic theory was one of the main concerns of proponents of the German historical school, who disagreed with the viewpoint that economics could rely solely on abstract general laws. List (1856), for instance, criticized classical political economists for supposing that free trade brought universal benefits. According to List (1856, 295), "[i]t is a very common clever device that when anyone has attained the summit of greatness, he kicks away the ladder by which he had climbed up, in order to deprive others of the means of climbing up after him. In this lies the secret of the cosmopolitical doctrine of Adam Smith."

List was perhaps the first to understand that while free trade served the interests of advanced capitalist societies, it impeded the progress of their less industrialized counterparts. Before implementing free trade policies, "it is necessary that the nations less advanced than England, should be raised by artificial means to the same degree of development at which England has arrived artificially" by using a protective system (List 1856, 207).

Influenced by List's idea of national economic systems, members of the historical school argued that the nation-state should be adopted as the unit of analysis, not individuals. According to Karl Knies (1853), the economic phenomena of national life are inseparably bound to the collective existence of nations. Individuals are part of the national unit and are deeply affected by shared culture, history, institutions, and habits. As socio-economic systems enclose individuals in a unifying frame, human behavior is conditioned by historical specificities. Consequently, the individual cannot provide the starting point for economic theory.

The search for a historically grounded theory of behavior encouraged a new field of inquiry. Primitive economics emerged in 1859 and elicited a debate as to whether or not the *homo economicus* was, as Smith implied, a universal principle. This debate continued from 1859 to 1945, and presented three distinct positions (Pearson 2000). The first position was that the aborigine's mind was essentially different from the modern's. Specifically, the assumption of instrumental rationality needed to be drastically relativized, meaning that rationality must be considered within specific social and historical contexts. From this perspective, there was no universal *homo* *economicus*, because the relationship between human beings and the economy depends on cultural, historical, and geographical conditions. The second position allowed that aborigines did pursue their goals deliberately and rationally, but it argued that their goals were irreconcilable with the principles of hedonism. Finally, the third position held "that the naked tribesman was every bit as much a *homo economicus* as the waistcoated banker" (Pearson 2000, 933).

Proponents of the historical school made contributions to the first two positions. From their perspective, fixed laws of human behavior eliminated the possibilities available to agents and were, therefore, at odds with the existence of "free will" (Knies 1853). But the effect of studying primitive economies was clearly corrosive of Ricardian pretensions for a grand theory. Was there any way that human biases, impulses, and affinities could be reconciled to some metanarrative, grand theory, or covering law? (Pearson 2000).

Both discussions about national economic systems and primitive economics raised the question of the relativity of theory itself. Was the same economic theory applicable to different social-economic systems? Economic theory was itself a product of the socio-economic system, and hence, as the economic system changes, economic theory was bound to change alongside history. This represented a distressing conclusion for those who believed that economic theory should be a positive science, one carried out with the use of mathematical tools devoid of moral and social content. As a result, a debate regarding the role of history and general abstractions in economic theory took place among scholars of the Austrian, German, and British schools.

Methodenstreit

The *Methodenstreit* is typically viewed as the clash between Carl Menger and Gustav von Schmoller. However, the dispute between these two figures does not provide an accurate account of the debate between the Austrian and German schools. According to Alessandro Roncaglia (2001, 305), both used rhetorical devices to call into question each other's position, in turn, stretching and distorting the opponent's view. The caricatured way the clash is presented, however, is sufficient for the argument in this paper.[8] The dissenting opinions were represented, on one hand, by Menger who argued for the central role of analytic reasoning in economic theory and, on the other hand, by Schmoller who rejected the reliability of abstract theoretical deductions and *a priori* assumptions in economic theory.

According to Geoffrey Hodgson (2001, 59), "the German historical school grappled with the problem of historical specificity. ... Clearly, however, the problem is tied up with other issues." As was often the case, distaste for general laws drove members of the historical school to empiricist claims that historical data were the source of truth. Wilhelm Roscher (1849, 182), for instance, asserted that "[w]e do not hesitate to declare economic science a pure empirical science. For us history is not a means, but the object of our investigations." This approach rejected universal theories in favor of particular theories based on simple description of specific phenomena (Hodgson 2001, 59-60).

Because of their faith in empiricism and inductive methods, many economists of the German historical school failed to realize that descriptions themselves rely on prior theories and concepts. The problem is that all sciences address both the general and the specific. "The nomothetic/idiographic dichotomy is untenable because all sciences are nomothetic as well as idiographic" (Bunge 1998, 23). Social inquiry must be simultaneously historic and systemic if it is to grapple with description and explanation of the real world. The German historical school became vulnerable due either to its disregard of general principles or to its inability to formulate them.

In other words, the historical school failed to acknowledge that statements concerning the context-specificity of theory must rest on some transhistorical abstract principles. Neglect of this point allowed scholars such as Alfred Marshall and Joseph Schumpeter to advocate the complementarity between the neoclassical model and the ideas of the German historical school.[9] In fact, Marshall's sympathy to historicism proved to be an important device in the debate. Although Marshall included much history in his writing, the analytical core of his theory was fundamentally static, abstract, and ahistorical (Moore 2003, 14). In *The Scope and Method of Political Economy,* John Neville Keynes's (1890) task, at the prompting of Alfred Marshall, was twofold: to delineate the methodological and epistemological underpinnings of the Cambridge orthodox position and to put an end to the *Methodenstreit* (Moore 2003). He achieved the latter goal by compartmentalizing economic theory, and then proposing a division of labor among the participants in the controversy. While the orthodox method must be used to analyze the abstract, static, universal, and deductive laws of exchange, Keynes argued that alternative methods could be used as the basis for concrete, dynamic, and specific inquiries.

In sum, the conciliatory strategy articulated by John Neville Keynes (and to a lesser extent by Marshall) "amounted to preserving each of the fundamental principles of the orthodox framework by re-reading the associated elements of the historicist framework along orthodox lines. Instead of grafting the historicist framework onto the orthodox framework, [John Neville] Keynes used his orthodox-tinted spectacles to conflate, subordinate, and marginalize it" (Moore 2003, 18).

The pretense of pluralism eliminated any reasons for further debate. In practice, pluralism meant the creation of a disciplinary hierarchy in which history played a subsidiary role in economic theorizing. With abstractions based on human nature being the starting point of theory, the ostensible victory of the Austrian school placed economics under the nomothetic rubric. This victory was achieved through rhetorical battles.

The dichotomy between history and theory in economics guaranteed every specialist his/her legitimate place and relative importance. In effect, John Neville Keynes kept the orthodoxy at the top of the hierarchy. Orthodox ahistorical, universal, and abstract laws must guide concrete research. All economists, therefore, had to master the discipline's abstract principles, including those concerned with historical specificities (Moore 2003, 25-31). According to Roncaglia (2001, 305), "the defeat of the historical school in the rhetorical confrontation for many years obscured the importance of an approach that tied in theoretical work with historical research." As I show in the next section, neoclassical economics has avoided the introduction of historically grounded principles into the core of economic theorizing.

The Core of Economic Theory: Attacks and Responses

By the end of the nineteenth century, classical liberalism was the dominant view in economics. The first half of the twentieth century, however, marked a politically disruptive period. Faced with convulsive times, classical liberalism appeared inadequate. Its premises assumed away problems of economic instability, crises, or unemployment. In this framework, the free market and its equilibrating forces would be sufficient to address most such issues.

The validity of the postulates of classical liberalism depended on a perfectly competitive market structure, in which a set of atomistic petty bourgeois, with no privileged or monopoly position, exchanged commodities through barter (Henry 2003). In addition to its incompatibility with the economic structures emerging at the time (e.g., oligopolies) perfect competition included other assumptions such as perfect information, no externalities, efficient markets, predictable risk, and complete intertemporal markets. According to this view, the economy was immune from gluts, instability, and uncertainty. Classical liberalism could not explain capitalist crises because it assumed away capitalist social relations and pecuniary motives.[10]

Due to these inadequacies, beginning in the 1920s, economists recognized the necessity to defend capitalism through different theoretical approaches than those of outmoded classical liberalism. John Maynard Keynes ([1926] 1932) figured prominently in this effort.[11] For him, neoclassical theory could not grasp the inherent instability of the economy because it did not grapple with the historically specific institutions of capitalism.[12] Keynes ([1933] 1989, 408) believed that in a capitalist economy "money plays a part on its own and affects motives and decisions," that entrepreneurs produce in order to accumulate money, and that consumption could be postponed indefinitely. These properties of capitalism give rise to the principle of effective demand, and hence instability and uncertainty (Keynes 1936, 235). Because of uncertainty, decisions about the future "cannot depend on strict mathematical expectation, since the basis for making such calculations does not exist." Economic decisions are often based "on our motive on whim or sentiment or chance," rather than of hedonist rational calculation (Keynes 1936, 162-163).

John Maynard Keynes's *General Theory* seemed to provide a palatable alternative to neoclassicism, while remaining within the constraints of capitalism. For him, the solution to economic instability and the inequitable distribution of income and wealth could be achieved through government intervention. Despite the apparent success of Keynesianism during the post-war period, already in the 1920s and 1930s, Friedrich von Hayek, Ludwig von Mises, and other members of the future Mont Pèlerin Society (MPS),[13] were planning an attack on Keynesianism and joined forces to resurrect liberal ideology.[14] Members of the MPS formed multiple study groups, each one concerned with a different issue. The group concerned with government intervention introduced a model embedding government within the marginalist theory. Government became just one more economic agent, conforming to rational-choice behavior (Horn and Mirowski 2009).

Furthermore, shortly after *The General Theory* was published, attempts to squeeze it into a neoclassical model were initiated. According to Hyman Minsky (1975), John Maynard Keynes's ideas were diluted by those keen to compromise with neoclassical economists or to render his concepts mathematically tractable. Minsky asserted that only three steps were necessary to rid Keynes's heretical contribution from the discipline: consumption function models, commodity and money market equilibrium models (i.e., the IS-LM model), and production function and preference-system models to derive equilibrium in the labor market. These brought Keynesian economics back to neoclassicism.

According to Pearson (2000), the field of primitive economics was destined to a similar fate. By 1945, the field was essentially eliminated, the principle of *homo economicus* was held to be applicable at every point in time and space. Economics played a leading role in this process as it gradually redefined itself as neoclassicism. As economics was being recast as a pure science of choice, empirical quibbles over human behavior were ruled out of bounds. As expressed by Oliver Leroy (1925, 12), "man appears to us always and everywhere, in history and in prehistory, as a being who practices a conscious economy, however rudimentary it may be. We know only *homo faber.* Therefore if there has existed a being displaying somatic analogies to man, but deprived of that which characterizes *homo economicus,* with its anatomy and manners derived from zoology, this interests neither the economist nor the economic historian." The ultimate upshot is that, were human nature not universal and history not a linear process, it could not be a subject of concern to economics. Principles of economic theory must be universal. Otherwise, the discipline was bound toward scientific confusion and practical chaos (Goodfellow 1939, 3-5).

The same fate befell institutional economics. Erik Reinart (2006) laments that "new institutional economics" became neoclassical economics with institutions (mainly property rights), something very different from the concerns with historical specificity of the much broader "old" institutional school of Thorstein Veblen and others. As in Menger's program, the central project of the new institutionalists, initiated by Oliver Williamson (1975), is to start with given individuals, in an institution-free state of nature, and to proceed to explain the emergence of institutions from that starting point. Menger's work on the nature and unfolding of institutions is widely and rightly regarded as thematic for what has become known as new institutional economics (Hodgson 2001, 92).

A similar destiny is shared by many other alternative approaches (Reinart, 2006). Meanwhile, neoclassical economics has gained much flexibility. Diane Coyle (2007, 251) explains that "[t]he only key elements of economic methodology, unchanged from the classical days, are the status of rational choice and the use of equilibrium as a modeling concept. ... We may permit imperfect information, transaction costs and other intervening variables to muddy the waters, but we do not model behavior as being determined by forces beyond the control of the individual."

Already in 1781, Jeremy Bentham put forward what was to become the core of orthodox economic theory. Bentham explained that individuals are self-interested beings, whose economic decisions are based on a calculation of happiness and suffering. Moreover, Bentham ([1781] 2000, 15) suggested that "[t]he community is a fictitious *body,* composed of the individual persons who are considered as constituting as it were its *members.* The interest of the community then is … the sum of the interests of the several members who compose it." Ultimately, behavior is not determined by any force, whose origin is external to the individual. Rather, it is independent of social context. In other words, behavior is universal.

The possibility of applying an economic calculus to *all* human behavior turns economics into a method (Coyle, 2007). Neoclassical economics is defined according to its method — rational choice, and not by its subject matter — the production and distribution of wealth (Hurtado 2008, 337).[15] Thus, as economics is reduced to the logic of rational activity, the universality of rational human behavior must be maintained to provide coherence. At the same time, neoclassical theory, now conceived as a method, becomes extremely flexible.

Heterodox economists are likely "amused by the [mainstream] newfound importance of institutions, history, entrepreneurs, innovations, spillovers, and social capital, long acknowledged as rudimentary by heterodoxy" (Reardon 2009, 396). Those conceptions are, however, a new icing on a perfectly solid neoclassical cake (Coyle, 2007). In other words, there is room for other approaches as long as they do not threaten the core principles of neoclassical economics.

As I intend to show in the following section, development theory went through a similar process of absorption by neoclassicism. Just as the German historical school a century before them, Latin American theoreticians spoke of the questions of historical specificities and argued that the neoclassical framework was applicable to developed countries, but not to their own peripheral countries. Again, just like the members of the German historical school, they did not realize that a coherent development theory depended on historically grounded principles. Initially, they accepted the assumptions of neoclassicism to explain advanced economies and, therefore, did not eliminate the universal behavioral abstraction from their argument. As a result, historical specificities were incorporated only at the margins of their theories (Rodriguez 2006, 43-128). Finally, in the 1960s, Latin American structuralists and dependency theorists attempted to break away from this pattern. The twenty years between the end of World War II and the wave of debt crises and *coups d'états* in Latin America, however, were not enough to give rise to a theory that coherently dealt with historical specificity.[16] This weakness left dissidents, once again, unarmed before rhetorical counterattack by neoliberals. The latter claimed that the assumption that peripheral countries functioned differently than advanced ones was fallacious. For the (neo)liberals, development theory was redundant because the neoclassical "one-size-fits-all" model could deal with both advanced and peripheral countries.

The Origin of Economic Development Debate

Historical Conditions

The flaws of classical liberal policy were not only felt in advanced countries. The Great Depression created serious balance of payments disequilibria in Latin America. Economists and other policy makers responded to the economic crisis and the depression-and-war impediments to international trade by implementing proto-Keynesian policies, such as the import-substitution industrialization program. Despite the lack of theoretical foundations, balance of payments constraints led Latin American governments to support these programs (Furtado 1968, 193-245).

In the post-World War II period, John Maynard Keynes's contribution was not only relevant to advanced capitalist economies, but also influenced South American scholars, who began to look at their economies from a new vantage point (Meier 1984, 15). Latin American reformers and nationalists made strenuous efforts to make good on the promise of democracy and development offered by the Allied victory. In 1949, their quests were attended to by the Truman Doctrine, which proclaimed the modernization of developing countries as a strategy against communism. The preoccupation with the peripheral world meant the creation of development policy based on financial aid. The execution of these programs required some theoretical guidance. As a result, a number of competing theories created by Marxists, Latin American structuralists, and neoclassicals were developed to understand the conditions responsible for underdevelopment and to formulate models to eliminate them. This section is concerned with the emergence of these theories and the debates surrounding them.

The Pioneers

By the 1950s, the enthusiasm of anticolonial leaders like Jawaharlal Nehru for national planning programs (influenced by the USSR's five-year plans) became a serious concern for Western powers (Engerman 2010, 235).[17] Economic development was transformed from an academic issue into a matter of national and international interest (Dulles 1956, 124-125).

Support for national planning prompted a Western response because of the ideological content embodied in such policy. Following a request from President Dwight Eisenhower to elaborate a pro-capitalist theory of development, Walt Rostow (1960) wrote *The Stages of Economic Growth: A Non-Communist Manifesto* (Engerman 2003). In this book, Rostow proudly trumpeted foreign-aid programs to former colonies and Latin America as an antidote to communist revolution and a source of capitalist growth. Eager to dismiss Marxist theories that linked empire with capitalism, Rostow presented the development of all societies as stages of a uniform process of development, the archetype of development being U.S. capitalism.

For Rostow, a culture's history travels along a staged-linear trajectory toward mature capitalism, presumably to the end of human history. Rostow's methodology outlines social development as a linear and hierarchical process. That is, societies exist side by side in space, one after the other in time (or one before the other), representing different "stages" of a general process of growth. Societies moved at a different pace, but they ultimately traveled towards the same destination: U.S. liberal capitalism.

Stage-growth theory ranks cultures along an evolutionary or linear scale, in which "primitive" culture is inferior to the culture of civilized peoples. Contact with modernity would ultimately eliminate deficient cultures. Rostow took capitalism for granted, making his historical explanation unavoidably ahistorical (Nisbet 1969, 168). His approach, like that of the classical political economists, ignored the social particularities of underdeveloped countries, while conceiving traditional societies as proto-capitalist or pre-capitalist.[18] For Rostow, if economic behavior was not universal (e.g., if it is instead subjected to cultural influence), then it was so malleable and accommodative that it allowed the adequate development of rational economic behavior. Development policy thus aimed at homogenizing culture and habits, thereby eliminating historical specificity. This would eventually translate into the elimination of development economics: When social homogeneity was achieved, there would no longer be a need for a theory to deal with social and historical specificities.

According to Michael Latham, Rostow's stage-growth theory functioned as an ideology. It reiterated an idea deeply held by liberals in the United States in the postwar period: "[T]hat their society stood at history's leading edge and that they possessed the power to transform a world struggling in its wake" (Latham 2011, 4). Development policies would not only contain the dangers of communist "subversion," but also dramatically improve the lives of millions of people in Africa, Asia, the Middle East, and Latin America.

A methodological problem emerged, however, when Rostow generalized his model to all realities. There is an infinite regress: There must have been some original traditional society that did not contrast with a more advanced external environment. For Rostow, the exception was Great Britain. But, one might ask: How can one understand the emergence of capitalism in England irrespective of its status as a colonial power? Such a theory denies the position that underdeveloped countries are a necessary condition for the existence of developed countries. In any event, Rostow's theory, while widely disseminated, was criticized from all sides — Marxists, structuralists, and liberals.

Latin American structuralists, for instance, did not believe that development could be understood in terms of natural stages following a linear process of growth. Latin America presented its own specificities that could not be categorized as some rudimentary stage, destined to become an advanced capitalist economy. On this subject, Raúl Prebisch (1949, 54) points out that "one of the most serious failures of the economic theory in general, from a view point of the periphery, is its false sense of universality." Prebisch's claim clearly resonates with complaints made by the German historical school a hundred years before him. Thus, "while he applauded [John Maynard] Keynes for turning the free-market chain of causation on its head in his attack on the guardians of orthodoxy, Prebisch felt that Keynes had gone only half the distance in explaining the dilemma of countries outside the core economies" (Dosman 2009, 218).

Moreover, although structuralists emphasized the importance of social structures peculiar to Latin America to explain underdevelopment, they believed that underdevelopment could not be satisfactorily explained solely by internal factors. Backwardness could, however, be explained by vulnerability and subordination in the international market. This understanding shows acknowledgement of historical conditions at a point in time, but not as the result of a historical process. In fact, Prebisch (2001, 19) argued that "to attribute to internal factors what very frequently was the result of external factors was a real calamity, a real theoretical calamity."

Structuralists took a step away from equilibrium analysis. From their perspective, growth did not follow a stable path and, moreover, engendered instability and imbalance. This was precisely what motivated Gunnar Myrdal (1957) to introduce international trade as a mechanism that exacerbated underdevelopment. For Myrdal, the tendency of laissez-faire to reinforce already existing inequalities called upon national governments to direct foreign financial aid in order to stabilize and ameliorate conditions in underdeveloped countries. Myrdal did not, however, explain underdevelopment. He showed how the free play of market forces reinforced already existing inequalities. Raúl Prebisch and Hans Singer shared these same ideas on international trade, and incorporated them into their theories. They saw an unfavorable position in international trade as the primary obstacle to prosperity for underdeveloped countries. For Prebisch, the economic function of the peripheral world was to provide food and raw materials for the center. In direct conflict with David Ricardo's theory of comparative advantage (later incorporated into neoliberal development discourse), Prebisch denied that the international division of labor permitted the advantages of trade to peripheral countries.

According to Prebisch, in developed countries increased productivity results in higher wages and profits, while prices tend to remain unchanged. But in peripheral countries these same mechanisms do not apply. Because underdeveloped countries are characterized by high rates of unemployment and underemployment, increased productivity does not translate into higher wages. Wages remain unchanged while prices of commodities produced in underdeveloped countries decrease. The different impacts of increased productivity on price in advanced and peripheral countries generate a tendency for deteriorating relative terms of trade for underdeveloped countries. Prebisch's supply-side analysis of deteriorating relative terms of trade implicitly supports the belief that the marginal productivity theory of distribution applies to developed countries. Provided the right institutions were implemented, he seems to suggest that it applies to the periphery as well.

Prebisch also presents a theory of the deteriorating terms of trade based on the structure of demand. The demand for necessities is less responsive to changes in income than the demand for luxury goods. If the periphery exports necessities and imports luxury goods, as income rises in the periphery "its ratio of imports to consumption tends to increase, leading to excess demand for imports, higher prices for manufactures and balance of trade deficits. In contrast, as income rises in the center, its ratio of imports to consumption tends to decline, primary product prices tend to fall, and the center's balance of payments tend to improve" (Saad-Filho 2005, 134). Deteriorating terms of trade then may be explained by differences in the income elasticity of demand for products made in the periphery and the center. In this part of his theory, Prebisch presents no criticism of the utility-maximizing consumer or universal human nature.

Structuralists claimed that peripheral countries could only escape the dilemma of underdevelopment through industrialization. In other words, the solution consisted of substituting capital-goods importation for an industrialization process promoted by financial aid (i.e., an import-substitution industrialization (ISI) strategy). By the end of the 1950s, Prebisch did not see a contradiction between developed and underdeveloped countries. He thought governments were capable of achieving what the free play of market forces could not: an optimal equilibrium, and thereby mutual advantages of international trade. Just like Friedrich List, Raúl Prebisch believed that through government intervention peripheral countries could achieve the same degree of development as advanced countries.

Despite their introduction of a new interdisciplinary approach to the economies of Latin America, structuralists remained attached to the ideals of emulating advanced capitalist economies. Because they still saw history as a linear process, capitalism was the end of history. Furthermore, the exposed peculiarities of Latin America were limited to differences in institutions and political structures, which were mainly seen as obstacles to development. That is, the institutional setting was not seen as a constituent part of a worldwide system, in which elites made alliances to maintain the status quo. Indeed, structuralists lacked an appreciation for Latin American history and culture, they did not see "backwardness" as a result of colonialism, nor did they use cultural specificities to redefine economic goals. Finally, their theoretical framework introduced specificity as an afterthought, side-by-side with neoclassical concepts such as marginal productivity theory, income elasticity of demand, and the rational individual.

In sum, structuralism was defined by its concern with Latin America's social specificity, its understanding of underdevelopment as a consequence of peripheral countries' internal and external circumstances, and its view of industrialization policies as the way of overcoming underdevelopment. Nevertheless, it accepted neoclassical concepts that relied on a universal human nature, neglected the historical origins of subordination in international trade, and believed such subordination can be eliminated through the process of institutional emulation. Apparently, historical specificities were not important enough to be included in their theories from the outset. Again, historical specificities were malleable and only existed until homogenization was achieved through institutional change.

Celso Furtado and others in the Economic Commission for Latin America (ECLA) were strongly influenced by Karl Marx and saw a contradiction in the very idea of underdevelopment. According to Furtado (2007, 3), "the reality of underdevelopment – it is not certain that it existed – … implied, to a certain extent, the acceptance of the theory of international domination. [However,] we used to say that the theory of international dominance was Marxism, imperialism, [John] Hobson [ism] and his cursed ideas. These ideas were not accepted, they were not considered to be serious; it was not economics. To talk about domination was considered to be a fantasy." This lack of space for Marxism in Latin America pushed all Marxists of the region to support Prebisch's theory (Furtado 2007, 4).

In the mid-1960s, however, it became clear that the relative success of industrialization had been insufficient to prevent a substantial increase in poverty and inequality. Growth had not benefited the low-income masses, while the high-income oligarchy flourished. Prebisch and a less optimistic ECLA started analyzing the effects of industrialization on employment and income distribution (Bielschowsky 2009, 175). In this period, Marxists and *dependentistas* took up the ECLA argument with the objective of redefining it radically (Cardoso 1977, 10).

For them, the main failure of structuralism was its ahistorical perspective, which meant taking capitalism for granted. Structuralists analyzed underdevelopment mechanically, ignoring the dialectical relationship between underdevelopment and development. Those Marxists concerned with the question of development looked for their answers in history. For them, underdevelopment had its roots in colonialism, and, more precisely, in imperialism (involving the colonial, semi-colonial, and dependent countries). But colonialism and imperialism were part of the development of capitalism itself (Baran 1957, 144-173). One could not understand development or underdevelopment without an appreciation of the worldwide economic system (Frank 1967). The parts were related – that is, the structure determined the dialectics between wealth and poverty. The proper task, then, was "to study what relates the parts to each other in order to be able to explain why they are different or dual" and to change the relationships that produced these differences (Frank 1967, 60). Ultimately, this meant that fighting capitalism itself was the objective on international, national, and local levels. This conclusion was far from being unanimous among Marxists. Some dependency theorists believed it was overly structural and simplistic, and unable to draw together the general and the particular in a specific dialectical whole (Cardoso 1977). It focused on the external factors of dependency instead of looking at the interrelation between capitalists in advanced countries and a peripheral bourgeoisie.

Emphasizing the historical impact of international capitalism, other dependency theorists, such as Fernando Cardoso and Celso Furtado, aimed at grasping the political alliances, ideologies, and structural changes within dependent countries. History started to be introduced in a non-linear fashion. With a focus on class struggle, *dependentistas* argued that peripheral capitalists were connected with and subordinated to the bourgeoisie of the Western world. "[A]lliances are established within the country ... to unify external interests with those of the local dominant groups, and as a consequence, the local dominated classes suffer a kind of double exploitation" (Cardoso 1977, 13). This approach pressed structuralists to move away from neoclassical concepts and to ground their analysis on historical principles. Prebisch, for instance, began to focus on the economic surplus to explain inflation and inequality and to show that peripheral capitalists used a large share of their income to engage in importation of luxury goods — imitating the consumption patterns of the centers — to the detriment of investment in producible capital (Prebisch 1984, 182-186).

Dependency theory, world-systems analysis, ecological economics, as well as race, ethnic, and gender analyses, questioned both the empirical validity and the ideological impact of development theory, thereby paving the way for alternative left-leaning frameworks to understand global change. As a result, development theoreticians began to view history as a non-linear process, and to include historically grounded principles at the core of their theories. But by the 1970s, any hope for a unified development theory was ultimately lost. These new approaches addressed serious issues, but also represented a pessimistic position on any rapid path to development (Latham 2011, 165-175).

During the 1960s and 1970s, Latin American economists started enriching their theories with historically grounded concepts. If specificities referred to habits and conduct, history needed to be part of the theoretical core, rather than orbit around it. They realized that a meaningful theory of development would rely on the shift from abstractions based on human nature to historically grounded premises. But, just like the proponents of the German historical school, Latin American structuralism and dependency theory failed to produce a coherent methodology and theoretical alternative to the universal method of neoclassicism. The fragmentation of dissidents' analyses opened the possibility for a counterrevolution that had been prepared for decades.

The Counterrevolution

Whatever development economists were concerned about, it is clear that their strong emphasis on an active and centralized state to promote development in the periphery and on historical specificity represented a departure from neoliberalism. As a response, the Mont Pèlerin Society (or MPS) formed a group concerned with development, which was organized around the fear that an ill-conceived strategy to deal with underdeveloped countries could be advantageous to the spread of communism. However, by the end of the 1950s, when this fear was greatly diminished, liberals launched a fatal attack on development theory (Plehwe, 2009).

On one hand, by rejecting Keynesian-style fiscal policy as a coercive intervention, neoliberals argued that unrestricted markets were the path to true development because they allowed citizens to freely pursue their own interest. Neoliberal development policy brought comparative advantage back into the debate alongside other issues such as the export-oriented policies based on traditional agriculture and the exclusive reliance on private foreign capital (Röpke 1953).[19]

On the other hand, neoliberals launched a rhetorical attack on development theory as a field, claiming that development theory was based on the fallacy that the world was divided into developed and underdeveloped parts (Bauer 1958). This fallacious assumption was responsible for the adoption of special economic development measures. They relied on the premise that people all over the world behaved rationally and were equally capable of succeeding economically. In sum, the field of development economics was unnecessary and a "one-size-fits-all model" could deal with both underdeveloped and developed countries (Bauer 1958).

According to Michael Latham (2011, 175), during the 1950s and 1960s, development theory was based on a linear view of history and contained the promise that development had a clear end, directly implementable by government intervention and international financial aid. By the 1970s, however, the integrating assumptions of structuralism gave way to a sense of fragmentation, ambiguity, and uncertainty. Neoliberal economists reiterated the claims that economic progress was essentially linear and could be easily achieved by the forces of the free market. A few years later, structuralism was declared "outdated." A theory that confined the economy to the market replaced the models emphasizing the importance of governments and planning for solving the problem of underdevelopment. As Furtado (2007, 12) puts it, "[w]e saw a counterrevolution that transformed the world into a single economy."

Concluding Remarks

If the divorce of economics and history provoked by the *Methodenstreit* did not blind all economists to the importance of building a theory on historically grounded principles, it certainly did not provide guidelines to incorporate such principles. As discussed in this paper, Latin America experimented with two different development strategies over the last two centuries, which were both based, to a greater or lesser extent, on a linear view of history and on the principles of economic rationality. The shared understanding that both these models failed to produce a sustainable pattern of development in Latin America has opened space for rethinking development theory and policies in the twenty-first century.

There is a need to understand why the old theories failed to address the problem of historical specificity. As I argued in the paper, the view of history as a linear process posed a crucial problem. It implied acceptance of an a priori rational individual and of a notion that eventually — when peripheral countries reached a certain level of development — neoclassical theory could take over, resuming its economic policies. The problem of "underdevelopment" is not a problem of inadequate institutional structure per se, including lack of savings, backward social traits, or failure to construct adequate productive structures and financial markets. It is a broader problem, albeit one encompassing some of the issues discussed herein. Unless historically grounded assumptions and principles become part of the economic theory's core, economists would not be able to adequately deal with historical specificities or understand the roots of underdevelopment.

Once it is clear that history is non-linear, the problem of underdevelopment becomes something much more complex than development theorists of the 1950s admitted: That is, there is no easy path to development. It is impossible for peripheral countries to break with their productive, financial, and ideological dependency while still emulating core countries as a way to promote and formulate a model of development. Uncritical model replication helps reinforce power relations as well as widen the gap between advanced and peripheral countries.

My argument provides the ground for answering the question this paper raised at the beginning: Should development economists abandon theories formulated for advanced capitalist countries and "go native," or should they choose some middle ground to promote economic development? Certainly, development theory needs to take into account the social and cultural specificities of peripheral countries. This does not mean, however, that historicism is the alternative or that all the accumulated knowledge, supported by economic theory from advanced capitalist countries, must be discarded. Since the 1960s, history has experienced a paradigmatic shift (Hunt 1992). In contrast to their nineteenth-century counterparts, historians today accept that history is not the source of ultimate truths. They recognize that abstractions are necessary to carry out historical analyses. Moreover, modern historians possess the theoretical and methodological tools that allow for the inclusion of cultural and social factors as well as for understanding the interaction between agents and structures. These tools may be of use to economists who favor historically grounded abstractions.

Notes

1. In the preface to the second edition of his *Theory of Political Economy*, William Jevons did not hesitate in decreeing that Ricardian economics had to be eliminated from the discipline (Jevons 1879, xiv).
2. The term "cosmopolitical" comes from Friedrich List (1856, 295), who used it to refer to economists from the research centers of hegemonic powers.
3. Although his contemporaries did not see List as a member of the historical school, economists today believe his inclusion in the school is appropriate. His focus on national economic systems and their historical specificities greatly influenced the debates of the historical school (Hodgson 2001, 58).
4. For the role of politics in weakening development theory, see Natália Bracarense (2012).
5. For Braudel (1972), linearity is analogous to a teleological account of historical evolution. A non-linear account views social change as the result of movement of three social layers, namely: the everyday life representing people's custom, habits and mentality; the social and commercial relations; and political and ideological power.
6. According to Pearson (2000, 935), the work of Charles Darwin, among other things, created room for challenging the universality of such behavior.
7. Leon Walras (1874, 63-79) explains the difference between economics as a moral science (one that studies the relationship between individuals) and as an applied science (one that studies the relationships between people and things). Practicing economics involves a model based on the latter relationship. This is *pure* economics, constituting the ground upon which moral science must be built.
8. As I argue in this section, among the many methodological battles of the *Methodenstreit*, the Austrian school held the edge only in arguing for the need to base theoretical analysis on general abstractions. It is true that many scholars from the historical school, including the younger-generation Werner Sombart (1929), agreed with this position, but they did not develop historically grounded principles – a weakness that relegated history to a subsidiary role.
9. Just as Marshall's conciliatory take on the role of abstractions and history in economics put an end to the *Methodenstreit* in England, Schumpeter's compartmentalization of theoretical and historical methods played a similar role in Austria (Shionoya 2004, 337). See discussion of John Neville Keynes in the text below.
10. On one hand, Jean-Baptiste Say sees no distinction among the factors of production. Labor, land, and capital are on equal grounds and receive incomes based on their contribution to production.

That is, the peculiarities of capitalist class relations are eliminated from the model. On the other hand, the ultimate goal of production was to obtain utility through consumption. Thus, the pecuniary motives of capitalist production are not accounted for in his model (see, for example, Henry 2003).

11. In "The End of Laissez Faire," John Maynard Keynes argued that the assumptions of liberal ideology — the view of private property as a natural law, the conflation of individual liberty and the free-market, the existence of an invisible hand of the market, among others — were invalid. He then supported the thesis that the state needed to act in those areas in which private sector investment was inadequate to reduce instability and increase social welfare.
12. For institutional specificity of John Maynard Keynes's theory see James Crotty (1990).
13. The MPS consisted of a group of economists, historians, and philosophers who aspired to preserve liberalism in thought and practice. The group first met in Mont Pèlerin, Switzerland, in 1947, by invitation of Friedrich von Hayek, to discuss the threats imperiling Western values in the post-war era.
14. In his critique of John Maynard Keynes's "The End of the Laissez Faire," Ludwig von Mises formulated what would become the neoliberal apology for free markets: "Had [John Maynard] Keynes (really) spoken of the end of *laissez faire et laissez passer*, then he could not have failed to see that the world today is sick precisely because, for decades, things have not been regulated by this maxim. He who rejoices that peoples are turning away from liberalism, should not forget that war and revolution, misery and unemployment for the masses, tyranny and dictatorship are not accidental companions, but are necessary results of the antiliberalism that now rules the world" (Mises 1927, 191).
15. However, for Bentham, economics was a branch of legal studies that inherently brought judgment values — what yielded utility was good, what reduced it was bad. For Jevons, on the other hand, the felicitous calculus becomes a social philosophy: By separating economics from moral issues, Jevons uses Bentham's felicitous calculus to transform economics into a branch of mathematics.
16. Independently of any theoretical development, there were many political and institutional maneuvers that prevented development theorists from advancing their analysis. For more on the role of orthodox economists in political counterrevolutions backed by the CIA, see Greg Grandin (2006). For an illustration of the collusion among the Chicago School, the CIA, and Latin American authoritarian governments, see Naomi Klein (2008). For the influence of the debt crises and the IMF In facilitating the resurrection of neoliberal policies, see Jan Kregel (2008).
17. Some authors, such as Ragnar Nurkse (1952) and Paul Rosenstein-Rodan (1943), started writing on development to solve the problems of backwardness and poverty in Southern and Eastern Europe during the interwar period. However, in the 1950s, there was a shift in the discipline and, consequently, in the meaning of development theory. In the 1950s, development received the meaning it has today, thereby becoming related to economic policies for the "Third World."
18. A traditional society "is one whose structure is developed within limited production functions, based on pre-Newtonian science and technology, and on pre-Newtonian attitudes towards the physical world" (Rostow 1960, 4).
19. Wilhelm Röpke was a prominent member of the MPS. He was responsible for a study group on development policy together with Peter Bauer, Carlo Mötteli, and John Davenport.

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