**Economics and the Underdeveloped Economies: The Impediments to Growth ...**
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pg. 3

# Economics and the Underdeveloped Economies

*By Karl de Schweinitz, Jr.**

*The author distinguishes between development, which involves building institutions and new economic activities, and growth, which is concerned with increasing output (GNP)* per capita. *He argues that economics is fundamentally concerned with growth, but can give some useful advice for development planners. He identifies development problems as basically within the sphere of political scientists and sociologists. Dr. de Schweinitz, Professor of Economics at Northwestern University, is author of* Industrialization and Democracy.

The rise of the new states in Asia and Africa following the post-War break-up of western colonial empires has once again made the problems of development and growth a major concern of economics. Though Adam Smith had initially set it upon its course with *An Inquiry into the Nature and Causes of the Wealth of Nations,* the focus of economics shifted as industrial capitalism accelerated the growth of income and wealth in the western states. Neo-classical economists tended to view growth as the implicit consequence of individuals maximizing utility and profits in competitive markets. Or to put it another way, they tended to take growth for granted and turned their attention to the effects on the allocation of resources of changes in the parameters of individual choice in what were already developed economies. While neo-classical analysis was thus able to explain the role of relative prices in adjusting production to consumer demand, it had very little to say about the overall or aggregate performance of market economies. At the turn of the present century anyone interested in the latter would have done better to peruse the works of Marxian economists, who retained the classical orientation of Smith and Ricardo, than neo-classical economics.

All this was to change with the Great Depression and the Keynesian Revolution, the influence of which is hard to exaggerate. Methodologically, it reinstated macro-economics and in so doing impugned the stability of capitalist markets implied in neo-classical analysis. After Keynes it required an heroic effort to believe that the autonomous forces of demand and supply, if given free rein, would equilibrate the system at full employment. Moreover, Keynesian theory was a powerful stimulus to the measurement of national income and its components, leading at once to a great improvement in statistical and accounting methods and a veritable flood of quantitative data. Not only did Keynes destroy the economic rationale of *laissez-faire,* but he provided the measures by which governmental policy makers could at least attempt to assess systematically the impact of their decisions on economic processes.

With macro-analysis firmly established alongside of micro-analysis, economics was the better able to analyze the economic problems of societies which had not benefitted appreciably from the industrialization of the west and may even have retrogressed. These were made dramatically compelling by the emergence of the new states. The Nehrus, Nassers, and Nkrumahs who inspired colonial revolts and led the struggles for independence were not much inhibited by the market-oriented values of the capitalist world, but rather were anxious to use governmental powers to increase the rate of growth and break loose from the debilitating grip of subsistence. And given a world divided ideologically by the cold war, these aspirations could be ignored only at the peril of those nations which had long since put a subsistence life behind them.

Though economic development and growth have again become a major preoccupation of economics, it needs to be emphasized that the setting of these problems has very much changed from that in which classical economics originated. Adam Smith observed a world in which the pre-conditions for growth were reasonably well formed. A state with centuries of constitutional development behind it had established a rule of law which not only insured the maintenance of order in England, but allowed the society to make coherent public policy where necessary to meet the social-economic issues of the day. A large middle class with highly cultivated commercial skills, accumulated capital, and a passion to innovate and make profits out of the new industrial techniques had an assured position in society. Moreover, the labor force was mobile, inured to the demands of hard labor, and capable of acquiring the skills of industrial employment. These conditions are conspicuous by their absence in a large part of the non-western world. For the purposes of this discussion, therefore, it will be convenient to distinguish between growth and development. Growth may be defined as increasing output (GNP) per capita. Development has broader reference to the building of institutions, new lines of production, and the dissemination of attitudes essential for self-sustaining growth. The world of Adam Smith had been developing for centuries and was just beginning to grow. In Asia and Africa, as well as in Latin America, economic development and growth frequently must be achieved simultaneously.

It must be acknowledged at once that economics is concerned more with growth than development and so, paradoxically, does not have much to contribute to the explanation of the origins of growth. Recently it has been taken to task for this "failure," the charge being that while appropriate for growing systems the narrow concerns of economics do not explain much where growth is not taking place.[1] The causes of growth, it is said, inhere in the individual psyche and the cultural and psychological forces which induce individuals to satisfy their needs through entrepreneurial behavior.

These critics ask too much of economics. Unlike Marxian analysis, which attempts to encompass the totality of behavior, it does not pretend to be a complete science of society. Economics is concerned with market phenomena in nationally-integrated economies. Where these do not exist, its analytical techniques are non-operative. If one wants to learn about the economics of primitive or subsistence economies, one must turn to the anthropologist rather than the economist. But, since developing and growing economies necessarily create market relationships of some sort, economic analysis quickly becomes relevant to an understanding of the process.

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## The Impediments to Growth in Poor Economies

Growth depends either on an increase in available resources or an increase in the efficiency with which given stocks of resources are used. The former occurs when, for example, new lands are opened up or new mineral deposits are discovered, when the population increases or its age structure changes increasing the number of people of working age, or when increased saving makes possible additions to the capital stock. Efficiency rises as a result of the adaptation of technological changes in the organization of production at the resource, manufacturing, or marketing stages. Both theoretical analysis and empirical evidence show persuasively that technological change is by all odds the most important ingredient of growth.[2] This points up the crucial role of the entrepreneur, the person responsible for making changes in production functions. Whether these take the form of capital-saving, land-saving, or labor-saving innovation, someone must assess their productivity in terms of the additional net revenue they may be expected to yield and assume the risks of adapting them in the production process.

The economics of development and growth may be viewed as an analysis of the factors affecting the performance of the entrepreneurial function, of explaining how it happens that a society does or does not reach a stage when the function is so widespread that growth becomes self-sustaining. This is the stage that W. W. Rostow has referred to as the "Take-off into Self-sustained Growth" and W. Arthur Lewis as the period when net investment rises from less than 5 to more than 10 percent of the net national product.[3]

One may easily identify the general conditions that stimulate entrepreneurship. On the demand side, there must be markets capable of absorbing increased output, that is, markets characterized by relatively high income and price elasticities. On the supply side, there must be markets capable of providing the inputs—technical knowledge, saving, skilled labor—essential for innovation. The difficulty confronting poor societies is that they seem to be locked in a subsistence trap which prevents market conditions from being favorable for entrepreneurial behavior of the growth-inducing sort. In the domestic market, for example, per capita income is so low that potential demand is limited. Families with an annual cash income of $50 or less can do little more than meet basic subsistence needs. And it is not easy to expand market opportunities because of the interrelatedness of output. This is the so-called balanced growth problem which suggests that if industries A, B, C, . . . could increase output simultaneously, each one might provide the requisite market for the other.[4] But to expand on such a broad front might require far more inputs than are currently available.

If the poverty of domestic markets inhibits growth, the world market, though it does not suffer from the same disability, presents problems of its own. In the first place, there is the difficulty of access. Not only are underdeveloped economies likely to be far removed from the centers of world commerce, but their hinterlands may well lack effective transportation links with outlets to the world market. The latter difficulty, of course, may be overcome by the construction of transportation facilities, harbors, and other kinds of overhead capital which draw an economy together, but these strain the saving capacity of a poor economy, especially in view of the fact that such construction labors under relatively high capital output ratios.

Even more serious, the world demand for the output of the poor economies may be a "wasting" asset. The underdeveloped economies are producers of primary goods—cocoa in Ghana, coffee in Brazil, cotton in Egypt, jute in India, copper in Rhodesia—and the world demand for these does not always increase in the same proportion as the income of the mature economies which provide their largest market. For one reason, the growth of demand for agricultural food products is constrained by fairly rigid physiological limits to the satisfactions that may be derived from eating. For another, technological changes in the wealthy nations frequently make possible the substitution of synthetic for natural materials—for example, nylon for silk or cotton—thus weakening industrial demand for agricultural output. Finally, it is the service sector of the mature economies that expands most rapidly as income rises, and it tends to be a light user of raw materials.[5]

The relatively low elasticity of demand in world markets for the output of the poor economies imposes on them a balance-of-payments problem, which in the absence of external aid can inhibit growth. To the extent that they must import goods in order to develop growth sectors in the domestic economy, they must pay for them by exporting goods. And if the intensity of their import demand is greater than the world demand for their exports, an adverse balance of trade will slow down their advance. This problem will be all the more severe if the terms of trade move against the poor economies. That is, if the prices of primary products decline relative to the prices of manufactured goods, the foreign exchange earning capacity of a given volume of exports will also decline.

Turning now to the supply side, low per capita income in the underdeveloped economies inhibits the growth of saving. Such a high proportion of current income must be used to satisfy pressing subsistence needs that little is left over for accumulation. But this is not so serious a deterrent to growth as the paucity of population skilled in the techniques and motivated by the drives essential for developing the economic potential of a country's natural resource endowment. Saving is, as it were, passive, while entrepreneurial capacity is active. Saving does not necessarily induce the kind of investment which stimulates growth. Indeed in the underdeveloped economies a large proportion of the saving that does take place finds its way to mausoleums, shrines, and temples which, however important to the soul, does not add to productive capacity. Entrepreneurs, on the other hand, are not likely to be held up for lack of saving. Where there is the drive to exploit new techniques in the organization of production, there also will be ingenuity in promoting saving and in establishing the money and banking institutions which are necessary for mobilizing capital for national development.

That growth in the underdeveloped economies depends especially on technical changes in the primary

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sector is beyond doubt. Without increasing productivity in agriculture and mining, the underdeveloped economy will not be able to release workers for a manufacturing sector or acquire sufficient foreign exchange to take care of its import needs. Yet it frequently happens that the institutions of land tenure impede entrepreneurship. In India the lack of primogeniture leads, in the face of population pressure, to excessive fragmentation of the land, thus rendering the average farm too small for optimal utilization of agricultural technology. Or absentee landlordism, as, for example, in some parts of the Middle East, may deprive farm tenants of the incentive to improve the land since such a large proportion of the increment to output would be absorbed by the landlord. The latter, in his turn, has little reason to make changes because he already is doing so well. Where, as in mining, foreign concessionaires have developed the resources of the land, they typically have relied upon European technicians and managerial personnel and have done little to train the indigenous population for positions of responsibility, the latter being restricted largely to unskilled jobs. The underdeveloped economy, then, may well contain a modern sector which, however, is an enclave that has not induced a modernization of the surrounding economy, but rather expatriates earnings whose magnitude depends on a perpetuation of the circumstances which prevent modernization.

Finally, it should be noted in this discussion of supply conditions that poverty itself breeds poverty. Undernourished workers have neither the strength nor the drive to acquire the skills which would increase their productivity and so they remain undernourished. In such an environment it is all the more difficult to engender entrepreneurial behavior on a widespread basis for the burden of subsistence deprives individuals of the self-confidence and purposeful outlook which are the essence of the function.

## The Contribution of Economics to the Surmounting of Growth Impediments

Though on the strength of the discussion thus far economics may appear to have earned the Carlylean epithet, the dismal science, the outlook may not be all that grim. One of the most important propositions that arises from economic analysis is that economic activity is interdependent and interrelated. The price and output of one commodity depend upon the prices and output of all other commodities and resources and on the level and distribution of income as well. Leon Walras first demonstrated this theoretically, late in the previous century. In recent years the pioneering work of W. Leontieff with input-output analysis has made possible the empirical and statistical demonstration of this general equilibrium quality of economic systems. This characteristic of economic activity is one of the reasons why it is so difficult to start the growth process; by the same token it holds out hope for self-sustaining growth, once the general equilibrium system can be "broken into." For the very connectedness of production creates the inducements and opportunities to which enterprising individuals (or the state) may respond. And just as poverty breeds poverty, so success breeds success. If, then, the proper institutional conditions can be created, economic growth may release external economies which provide the markets for further growth and the incentives for individuals as consumers and producers to take advantage of them.

Moreover, if economics cannot explain why growth takes place initially, it does have a lot to say about policies appropriate for growing economies. Perhaps most important in this regard is its quantitative focus. As indicated at the outset, the governments of the new states are anxious to accelerate economic growth and so the contemporary era tends to be more planful than the age in which industrial capitalism transformed the western world. Without the measures of income and product that originated in the Keynesian Revolution it would be difficult for planners to know what it is that they are trying to develop. Indeed, for a poor society, a fundamental first step towards growth is to get to know itself quantitatively by organizing statistical services. This in itself is no mean achievement for communities whose values are strongly traditional and intuitive.

Further, economics can make explicit the probable consequences, for example, of alternative investment programs on the rate of growth of the capital stock, the construction of social overhead, the level of prices and wages, the balance of payments, the distribution of income, the demand for labor, and so forth, making possible an evaluation of costs and benefits which can go far in preventing wasteful mistakes. This may be done "unsystematically" through use of traditional iterative methods or through the programming of mathematical models—for example, input-output matrices—for computers. While these predictions may have a fairly wide margin of error, it is to be presumed that they furnish political decision-makers with better information than they would have had if forced to rely on hunches and unsystematized data. Whether or not political leaders in the new states take full advantage of the economic counsel available to them is, of course, a quite different question.

At this point one may conclude this article on a somewhat immodest note. However imperfect economics, it is further advanced as a policy of science than the other social sciences. And if it has not been more effective in helping the new states realize growth objectives, it is because so many of them have not yet developed institutions conducive to growth. For explanations of this lack of development, however, one should look to political science or sociology, rather than to economics.

## References

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2. Cf., E. F. Denison, *The Sources of Economic Growth in the United States and the Alternatives Before Us*. New York: 1962; S. Fabricant, *Economic Progress and Economic Change*. New York: 1954.

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5. Cf., R. Nurske, *Equilibrium and Growth in the World Economy*, edited by G. Haberler and Robert M. Stern. Cambridge, Mass.: 1961.

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