Underdevelopment and Institutions
## Summary of Liberal Theories of Development

<table>
<thead>
<tr>
<th>Stimulants</th>
<th>Internal</th>
<th>External</th>
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<tr>
<td></td>
<td>• Human Capital</td>
<td>• Opportunities to Catch Up</td>
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<td>• Entrepreneurial Spirit</td>
<td>• Foreign Investments</td>
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<td>• Efficient Government</td>
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<td>• Savings</td>
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<td>• Research and Development</td>
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<td>• Investments</td>
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<td>[ Modern Society ]</td>
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<td>Hindrances</td>
<td>• Political Instability</td>
<td>• Trade Barriers in the North</td>
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<td>• Corruption</td>
<td>• Absence of project finance</td>
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<td>• Traditional Society</td>
<td>• Absence of Balance of Payments finance</td>
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Dependency Theory is concerned with global inequality.....
Income distribution,

f13 Lecture Development\movie.swf
Absolute poverty is defined as living on the equivalent of US$2 a day or less. In 2002, 43% of the world population lived on this little. This money has to cover the basics of food, shelter and water. Medicines, new clothing, and school books would not be on the priority list.

When almost an entire population lives on this little, it is unsurprising if undernourishment is high, education levels are low, and life expectancy short. In both Nigeria and Mali, 9 of every ten people survives on less than US$2 a day.

South America has a relatively small poor population, yet 39 million people have less than US$2 a day in Brazil.

Territory size shows the proportion of all people living on less than or equal to US$2 in purchasing power parity a day.

“Trickle-down theory – the less than elegant metaphor that if one feeds the horse enough oats, some will pass through to the road for the sparrows.”

John Kenneth Galbraith, undated
Why this difference?
Dependency Theory’s explanation

• Dependency Theory rejects Liberalism’s central assumptions, arguing......

• The factors that liberals argued would contribute to growth actually contributed to inequality!
Dependency Theory: a theory of exploitation in international exchange

- Marxist theories were concerned with exploitation at the site of production
- Dependency theory focuses on exploitation at the site of exchange
- Core and periphery
- Core is enriched at the expense of the periphery: exploitation
- The opposite of comparative advantage
Dual Economies and Dependency

Core (North)       Periphery (South)

Core  Periphery

Periphery  Core
Core and Periphery in the Periphery
Terms of Trade are against the South

• What does this mean?
  – Overwhelmingly commodity exporters
  – Inelastic demand
  – Multiple suppliers drive down the price

• Constant deterioration in TOT means the South is always disadvantaged unless countries can export manufactured goods.
Commodities Trade

- WTO forbids subsidies on manufactured goods
- WTO does not cover trade in commodities
- South is dominant producer of commodities
- The North subsidizes its agricultural goods
- Poor farmers in the South can’t compete
- Doha Round has achieved nothing so far
Oil is the Exception
OPEC

• OPEC sets production levels which sets the price of oil
• Other commodity producers have tried to organize cartels like OPEC but haven’t succeeded because they were large groups
• OPEC is a small group
• Collective action is easier in small groups than in large groups
• New oil discoveries undermine collective action
MNCs and Dependency

- MNCs contribute to dependency
- No “trickle down”
- MNC brings in what’s good for itself, not what’s good for the country—prevents capital accumulation
- No investment in local firms
- Raise capital by buying out domestic firms
- Alliances between the rich in the South and the Rich in the North
- Create useless consumption through advertising
- Brain Drain
MNCs and Dependency

Core (North)       Periphery (South)

Brain Drain, profits and Luxury
Technology for Luxury production

Resource Extraction + Imports
The role of the IMF and World Bank in perpetuating Underdevelopment

• Conditionality and structural adjustment
• Only source of qualification for new loans
Aid contributes to Dependency

Core (North)       Periphery (South)

Core

Exports (paid for by aid)

Luxury Exports

Development Aid

Core

Periphery
How did this come about?

Core (North)          Periphery (South)

Concentration of Industry

Core         Periphery

Outdated and extractive technologies

Slaves

Core

Periphery

Resource extraction

Raw Materials
Southern Response to Dependency Theory: Economic Nationalism

- The “South” did not have the strength to participate in the international economy
- By 1960s, Independence for many countries
- And had clear majority in the U.N.
- Rose up against the GATT
The Problem of Development from an Economic Nationalist Perspective

• Exploitation of the South by the North
• Wealth of the Rich depends on the Poverty of the Poor
• Northern Dominance over the South
  – Colonial legacies
  – International institutions
  – Example of Doha Round of WTO Negotiations
• Dependency explanations, Econ. Nat. solutions
The Domestic Solution: ISI

• What is ISI? Back to Fred List!
• Infant industry arguments
• Close off from the internat. Economy for a while, then come back strong!
• This didn’t always work.
Some Problems with Dependency Theory

- Sometimes the surplus is invested in the host country—location of plants, services
- This can stimulate domestic industry and business
- The result: “Dependent Development”
- So maybe stagnation is not inevitable
- Singapore is a good example...
Why institutions are needed to spur development

• Poor countries can’t afford to wait while natural market forces work their beneficial effects.
  – Market forces take too long
  – Produce unbalanced economies
  – Vulnerable to price shocks
  – Vulnerable to manipulation by strong trading partners
Requirement for development: A developmental State

- Example of Soviet Union
- Compatible with Keynes
- Compatible with embedded liberalism
- Historical experience
- Gerschenkron’s contribution
If You’re Early, use the market! (?)
If You’re Late, Use the State!

- Development Banks
- The STATE
  - Czarist Russia and Soviet Union
The advantages of backwardness

- Need for rapid development
- British example
- British investment in a “developing” country: the U.S.
- Technology diffusion
- Late developers got the newest technology
- Why I call this perspective “modified Liberalism”
It pays to be late

• Latecomers grow faster
• Access to state-of-the-art technology
• Quick move to heavy industry
• Development is possible through contact with the International Economy
Leapfrogging: Access to the Latest Technology
Latecomers grow faster...

World GDP growth rates, decade averages

Economic Research Service, USDA
They move quickly to competitive industries
Development is possible through contact with the international economy

Globalization increases developing countries share in world trade

Exports from developing and developed countries, 2005-2030

US$2001 trln.

- High-income countries
- Developing countries

The more integration, the more growth
What is common to all theories of development: 
Accumulation of Capital is the Key

• Theories differ on the BEST way
• Trade?
• Aid?
• Technology transfer?
• State mobilization of capital?
• ISI?
• Growth of a middle class?
• Dependent Development?
What did Asia do right?
Growing share of World GDP

Graph showing the share of world GDP for EU, United States, Rest of Asia, China, and Japan from 1980 to 2006, with estimates for 2006. The graph indicates a growing share for China and Rest of Asia, while EU and United States show a slight decline. Japan's share remains relatively constant. Source: IMF. *At purchasing-power parity. †Estimate.
Asia-US GDP Growth

Asian and US GDP growth
Two quarter moving averages (YoY, %)

Asia 10*

Asia 8
(excluding China & India)

US

Jun 2005 06 07 Jun
Decline in poverty rate

Asia leads the decline in global poverty

Proportion of people living on less than $1 a day, 1990 and 2002 (Percentage)

<table>
<thead>
<tr>
<th>Region</th>
<th>1990</th>
<th>2002</th>
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<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>44.6</td>
<td>44.0</td>
</tr>
<tr>
<td>Southern Asia</td>
<td>39.4</td>
<td>31.2</td>
</tr>
<tr>
<td>Eastern Asia</td>
<td>33.0</td>
<td>14.1</td>
</tr>
<tr>
<td>South-Eastern Asia and Oceania</td>
<td>19.6</td>
<td>7.3</td>
</tr>
<tr>
<td>Latin America &amp; the Caribbean</td>
<td>11.3</td>
<td>8.9</td>
</tr>
<tr>
<td>Northern Africa and Western Asia</td>
<td>2.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Transition countries of South-Eastern Europe</td>
<td>0.4</td>
<td>1.8</td>
</tr>
<tr>
<td>CIS</td>
<td>0.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Developing regions</td>
<td>27.9</td>
<td>19.4</td>
</tr>
</tbody>
</table>
Liberal explanation
Attracting foreign investment, accumulating capital
The Product cycle?

Asian Countries building their R&D Investments

Gross R&D as Percent of GDP

Source: OECD Main Science and Technology Indicators. Compiled by the APS Washington Office.

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