

Underdevelopment and Institutions

So why do some countries stagnate and show little or no economic growth?

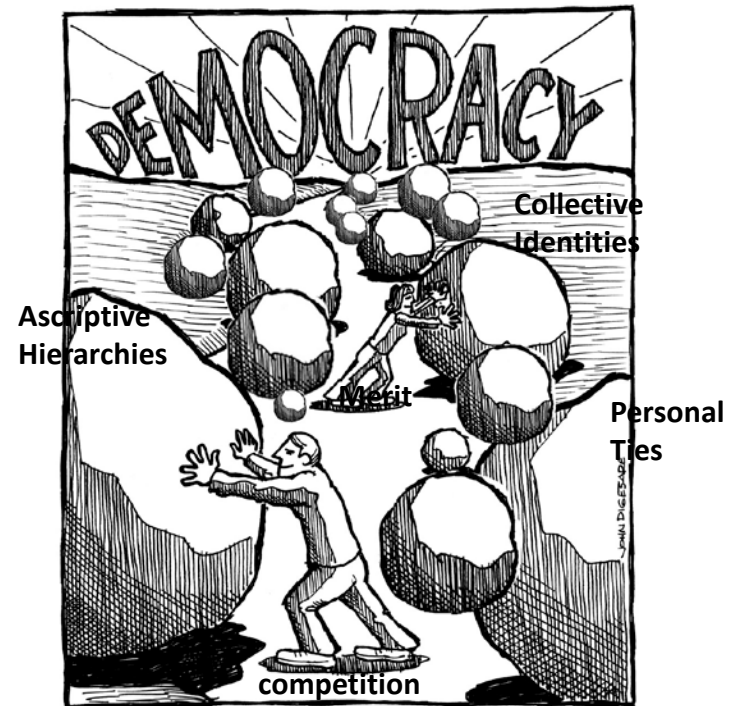
- External connections like trade and investment are important, but that's not all.....
- There are internal requirements for development as well....
 - Overloaded bureaucracies and elite/military consumption, rent-seeking
 - Traditional culture must give way to modern culture....

Tradition and Modernity

Tradition	Example	Modernity	example
collective unit of social organization	Religion, ethnic group, tribe	Individual as the unit of social organization	U.S. Bill of Rights,
Personal ties govern social organization and behavior	family, tribe (feed corruption, suppress entrepreneurship)	Pragmatic and functional ties govern behavior.	markets, professions, associations (feed merit and excellence)
essentialist Identity (one dimensional)	ethnic identity, religious identity, (us vs. them)	Multidimensional Individual identity	Example?
Identity derived from mystical principles	National identity (us vs. them)	Free choice of identity	See above (can conform to market signals)
Ascriptive hierarchies,	Kin groups, families (rigidity)	Functional hierarchies	Parliaments, (flexibility, change)

Democracy and Markets

- Democracy and markets encourage each other: political and economic freedom are two sides of the same coin



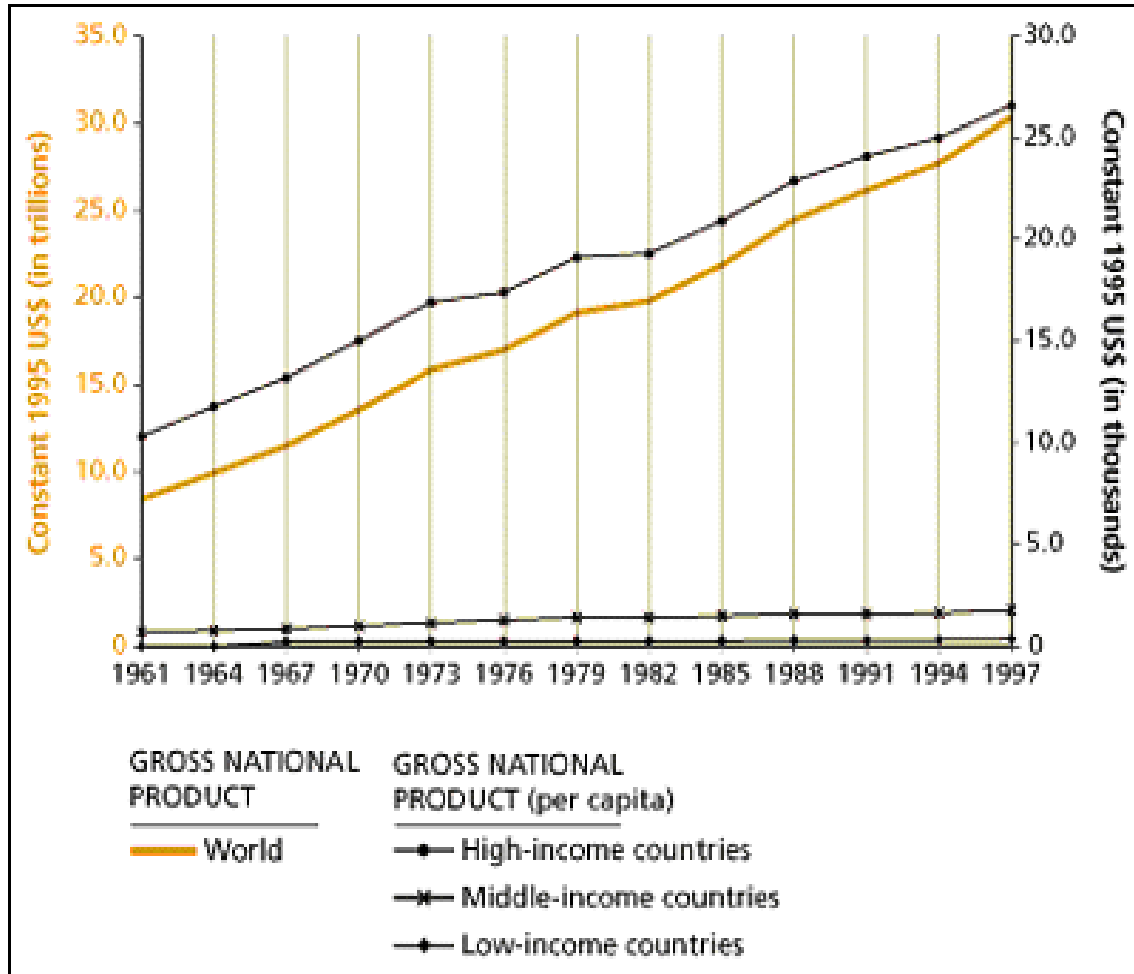
Liberal perspective in a nutshell

- Economic growth is part of “modernization”
- Demography and Technology create conditions for growth
- Accumulation of capital
- Mass Consumer society

Summary of Liberal Theories of Development

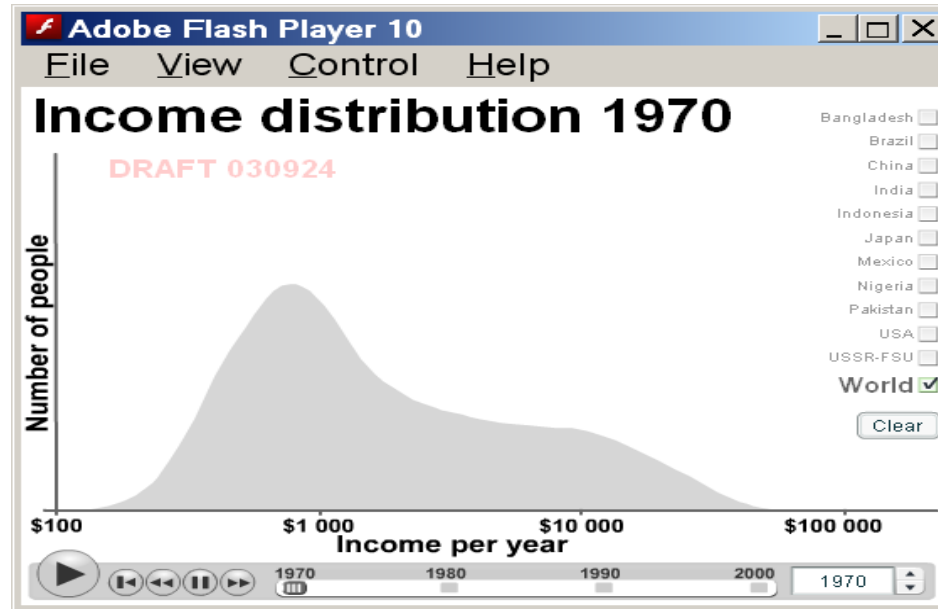
	Internal	External
Stimulants	<ul style="list-style-type: none"> • Human Capital • Entrepreneurial Spirit • Efficient Government • Savings • Research and Development • Investments <p>= <i>Modern Society</i></p>	<ul style="list-style-type: none"> • Opportunities to Catch Up • Foreign Investments • Trade • Aid
Hindrances	<ul style="list-style-type: none"> • Political Instability • Corruption • Traditional Society 	<ul style="list-style-type: none"> • Trade Barriers in the North • Absence of project finance • Absence of Balance of Payments finance

Dependency Theory is concerned with global inequality.....



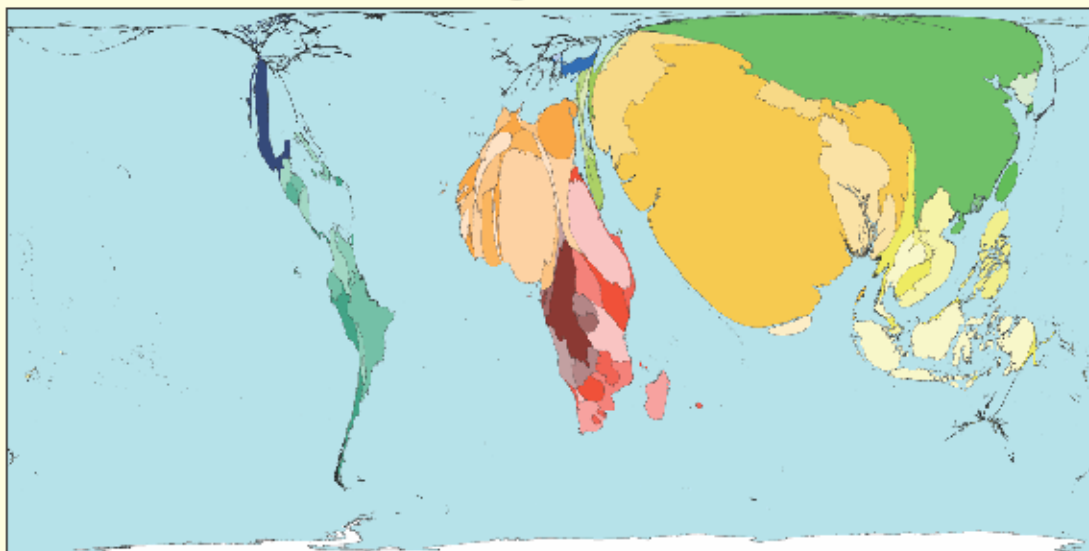
Income distribution,

[f13 Lecture Development\movie.swf](#)



And.....

Absolute Poverty



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.



Technical notes

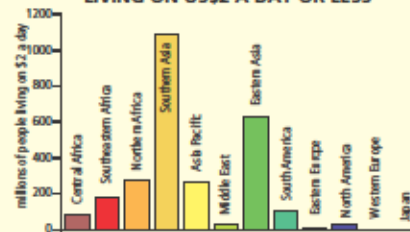
- Data are from the United Nations Development Programme's 2004 Human Development Report.
- *Omitted are territories where the regional average was assumed due to missing data: Democratic Republic of Congo, Angola, Congo, Gabon, Sao Tome & Principe, and Equatorial Guinea ranked 5th, the Maldives and Bhutan ranked 24th).
- See website for further information.

TERRITORIES WITH HIGH ABSOLUTE POVERTY LEVELS

Rank	Territory	Value	Rank	Territory	Value
1	Nigeria	90.8	17	Nepal	82.5
2	Mali	90.6	18	Burkina Faso	81.0
3	Burundi	89.2	19	Ethiopia	80.7
4	Zambia	87.4	20	India	79.9
11	Niger	85.3	20	Nicaragua	79.9
12	Rwanda	84.6	22	Ghana	78.5
13	Central African Republic	84.0	23	Mozambique	78.4
14	Madagascar	83.3	26	Cambodia	77.7
15	Gambia	82.9	27	Malawi	76.1
16	Bangladesh	82.8	28	Sierra Leone	74.5

percentage of population living on US\$2 a day adjusted for purchasing power parity*

LIVING ON US\$2 A DAY OR LESS



"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?



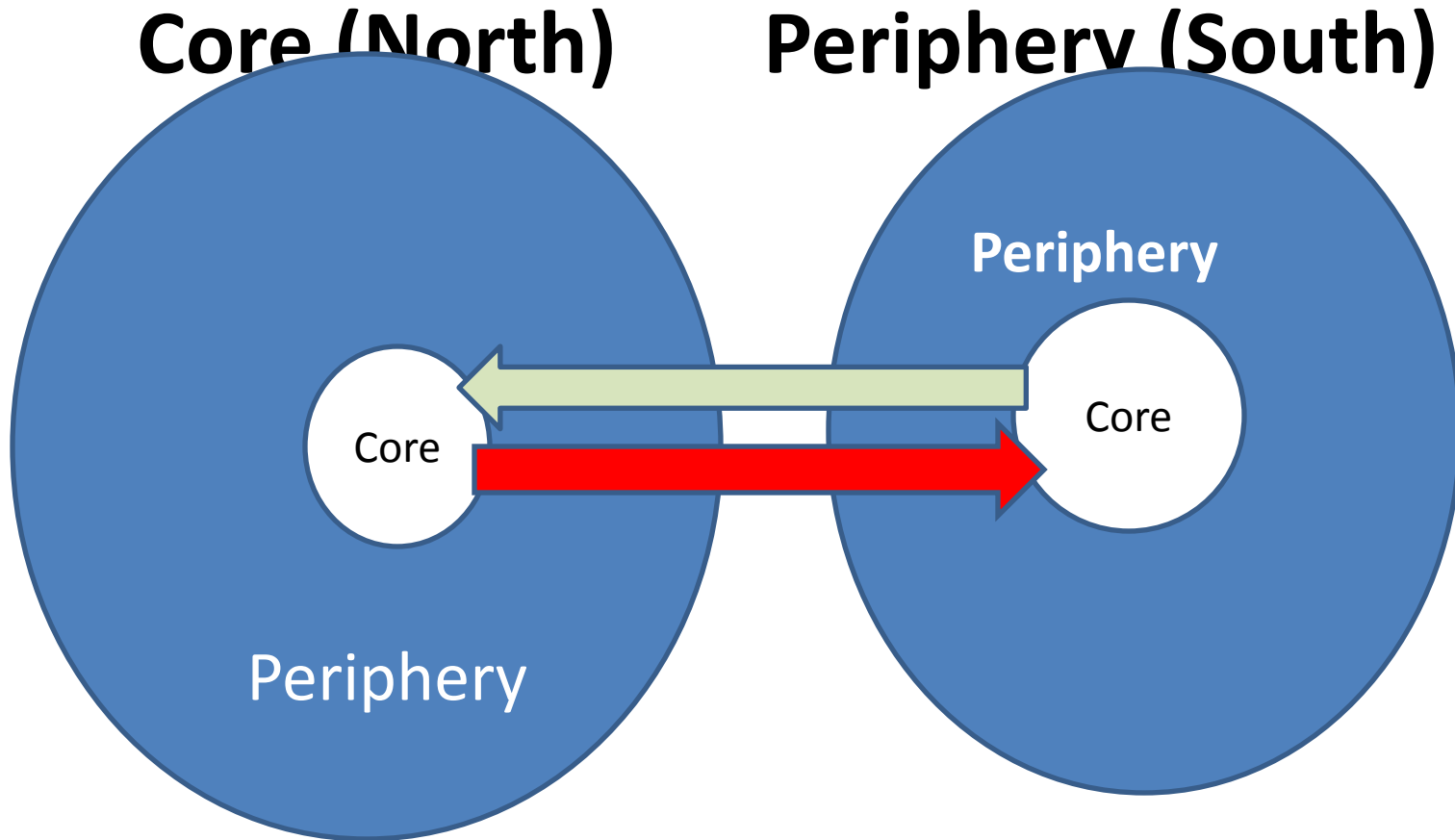
Dependency Theory's explanation

- 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 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



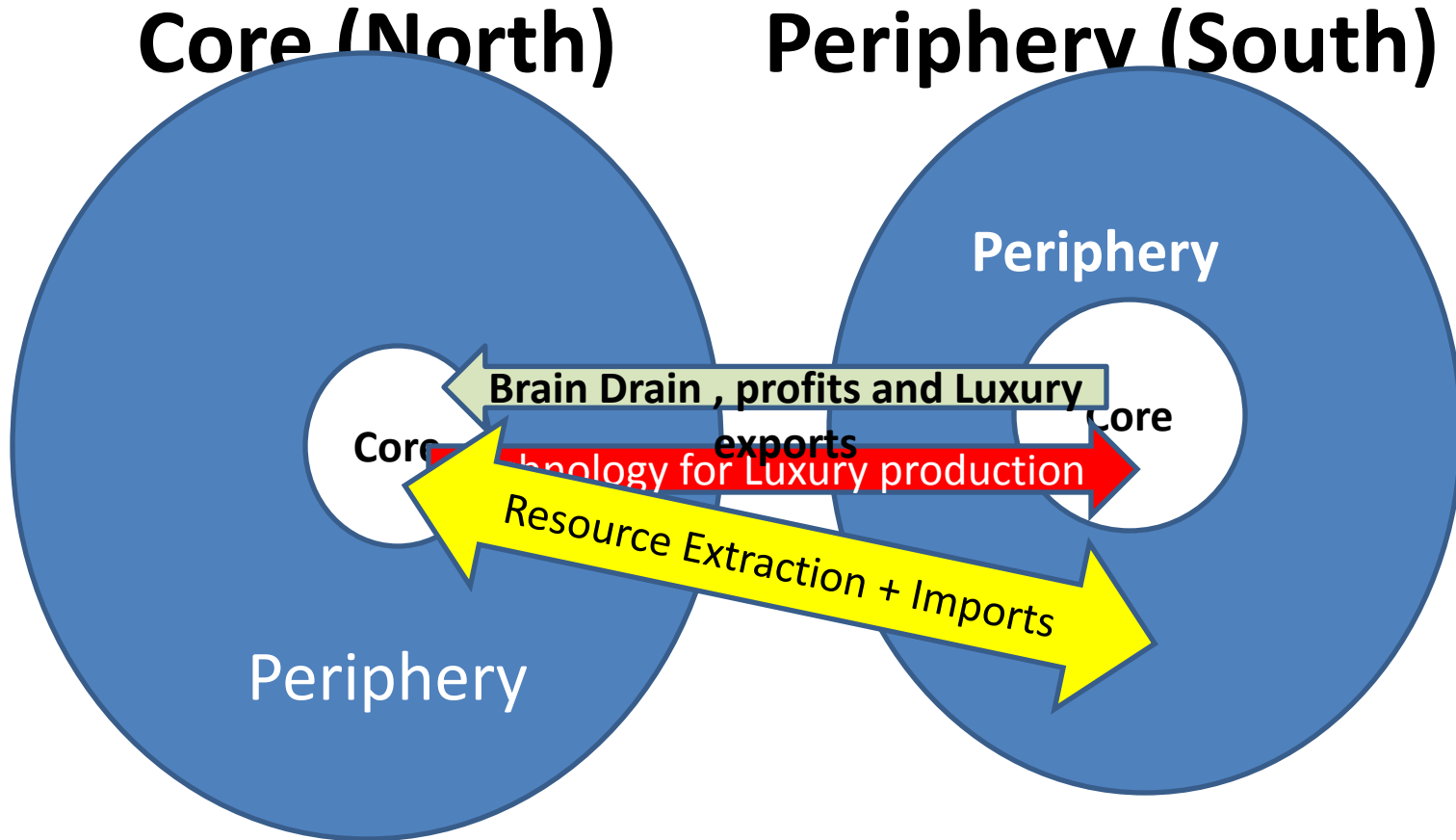
OPEC

- 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

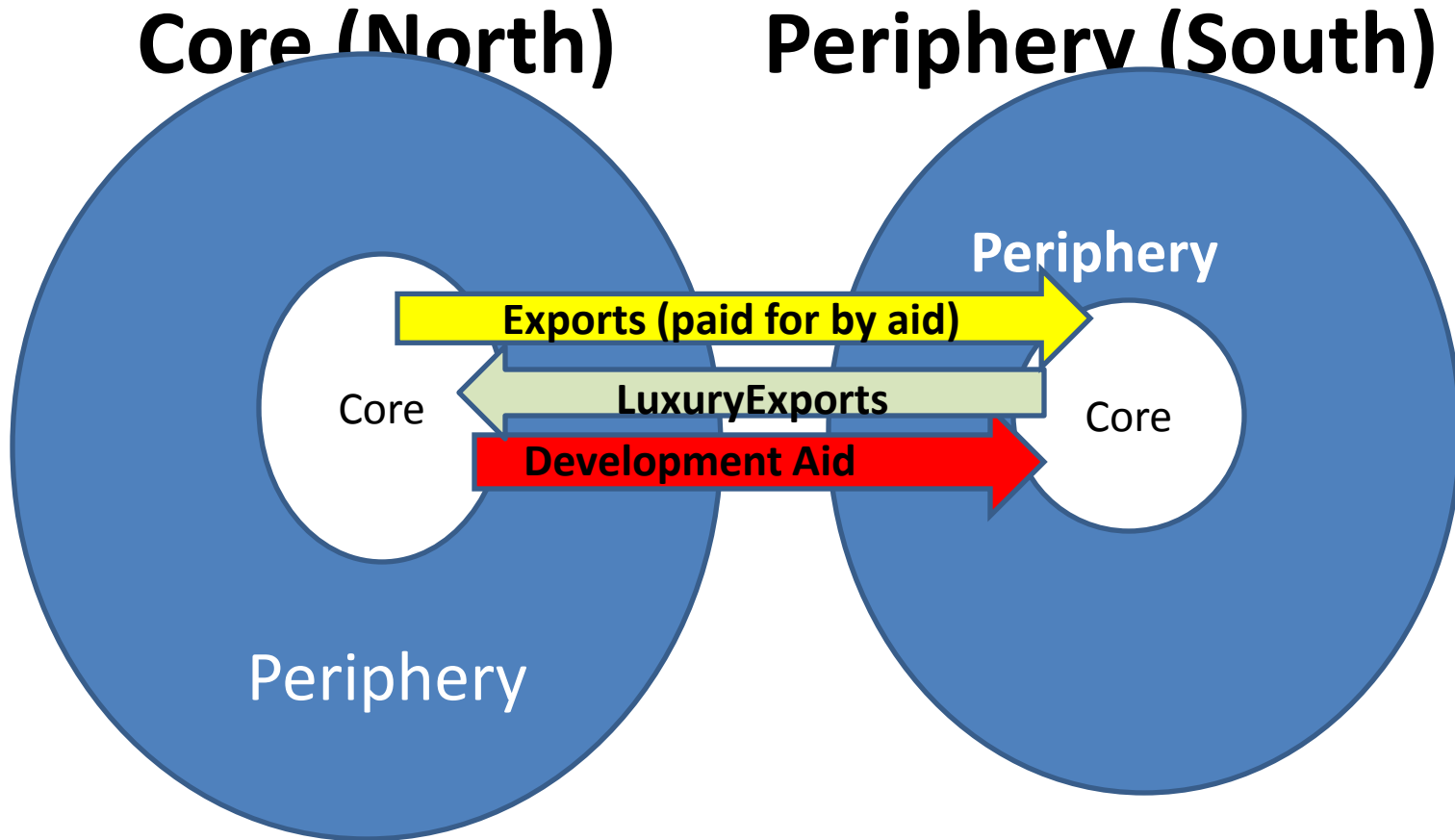
MNCs and Dependency



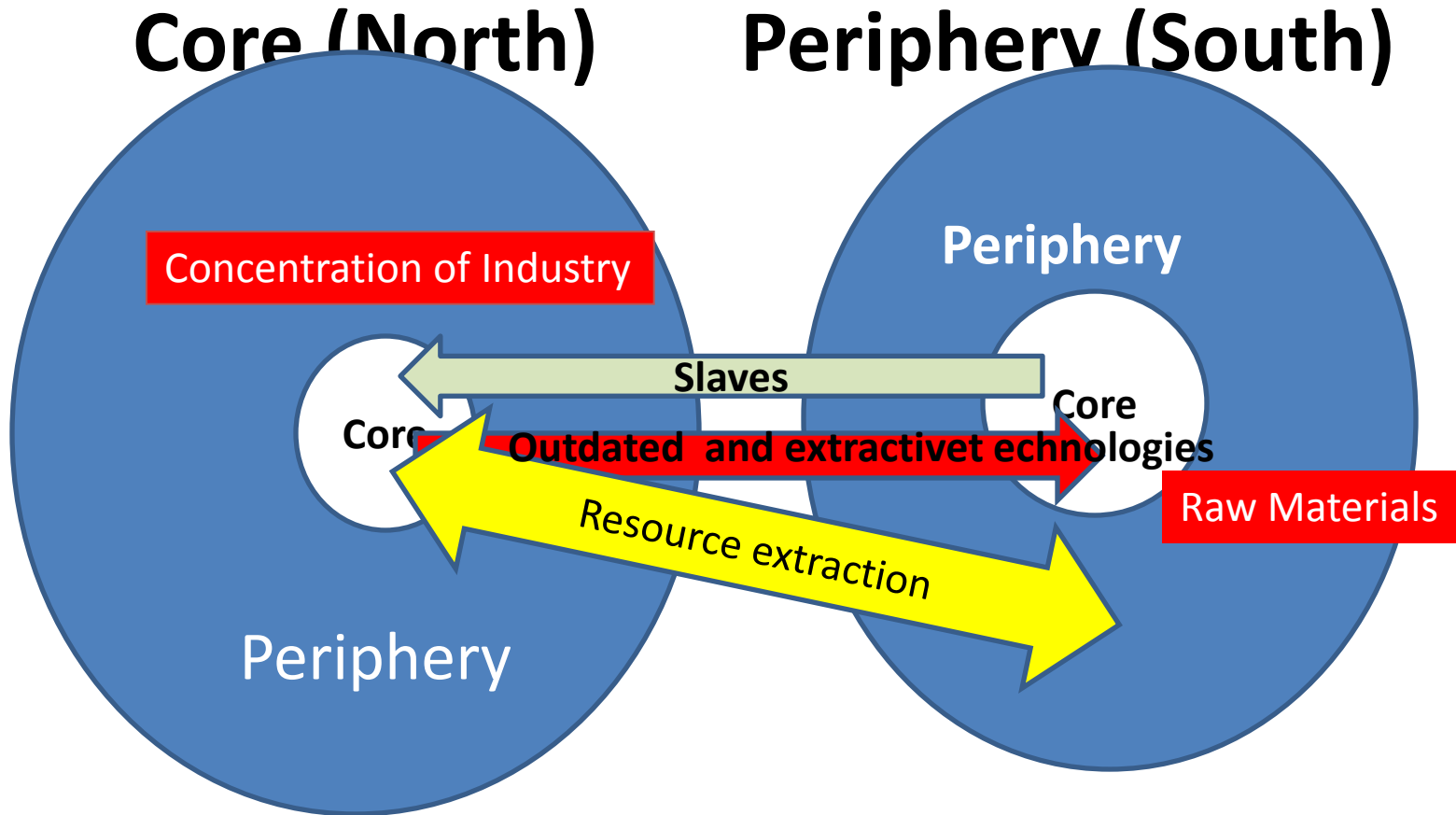
The role of the IMF and World Bank in perpetuating Underdevelopment

- Conditionality and structural adjustment
- Only source of qualification for new loans

Aid contributes to Dependency



How did this come about?



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

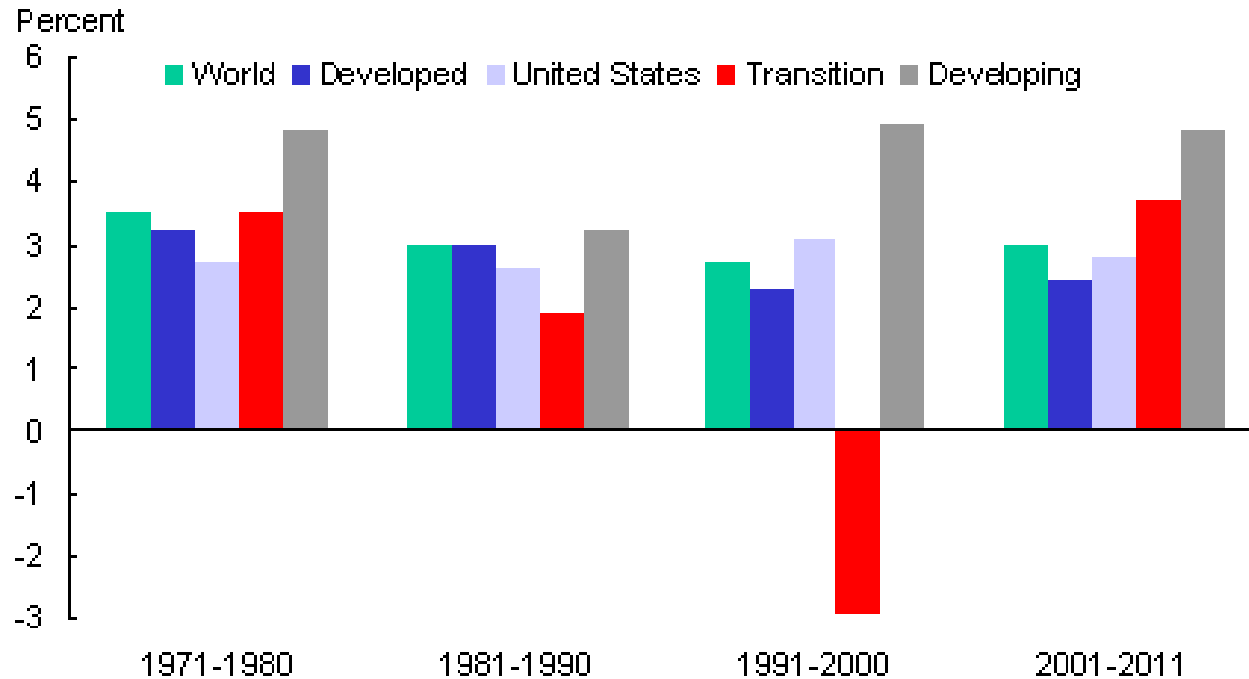
- Latecomers grow faster
- Access to state-of-the-art technology
- Quick move to heavy industry
- Development is possible through contact with the International Economy

Leapfrogging: Access to the Latest Technology



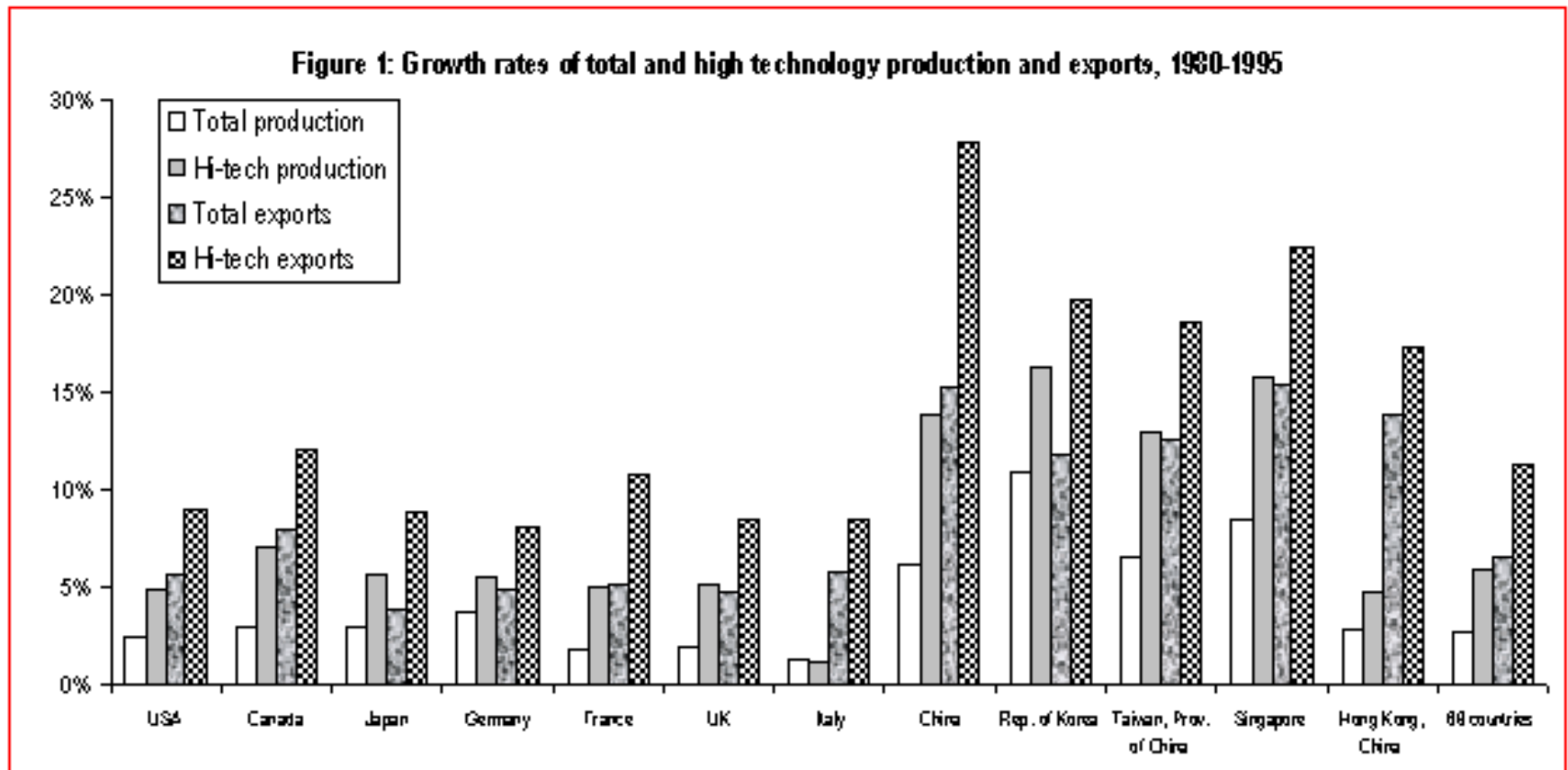
Latecomers grow faster...

World GDP growth rates, decade averages



Source: *USDA Agricultural Baseline Projections to 2011*, February 2002.
Economic Research Service, USDA

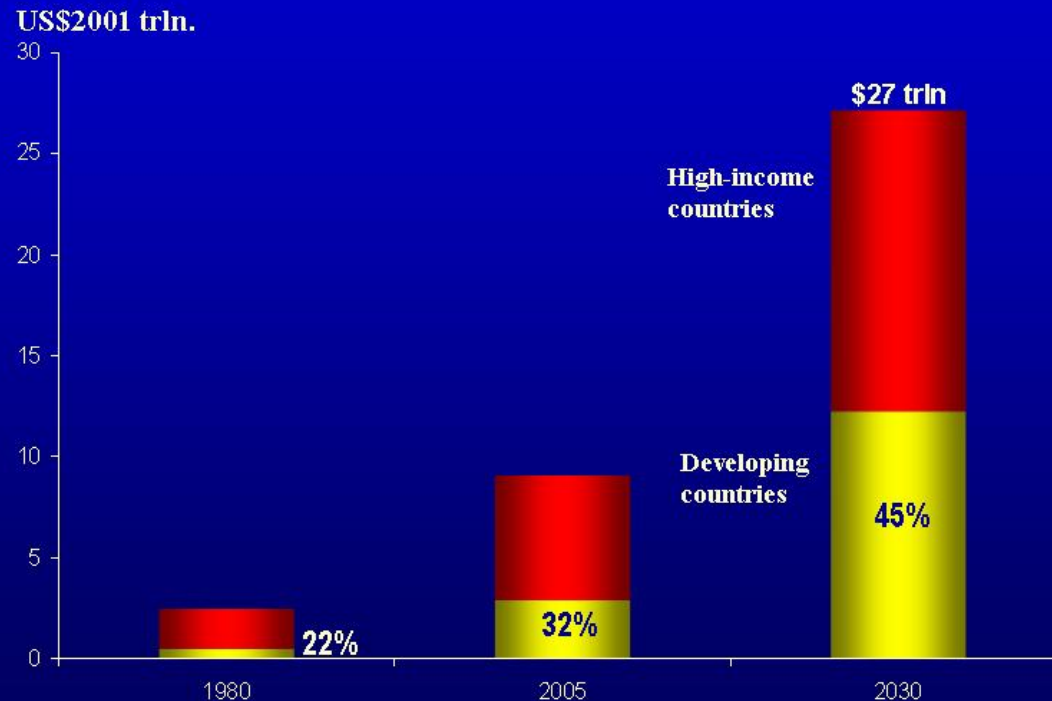
They move quickly to competitive industries



Development is possible through contact with the international economy

Globalization increases developing countries share in world trade

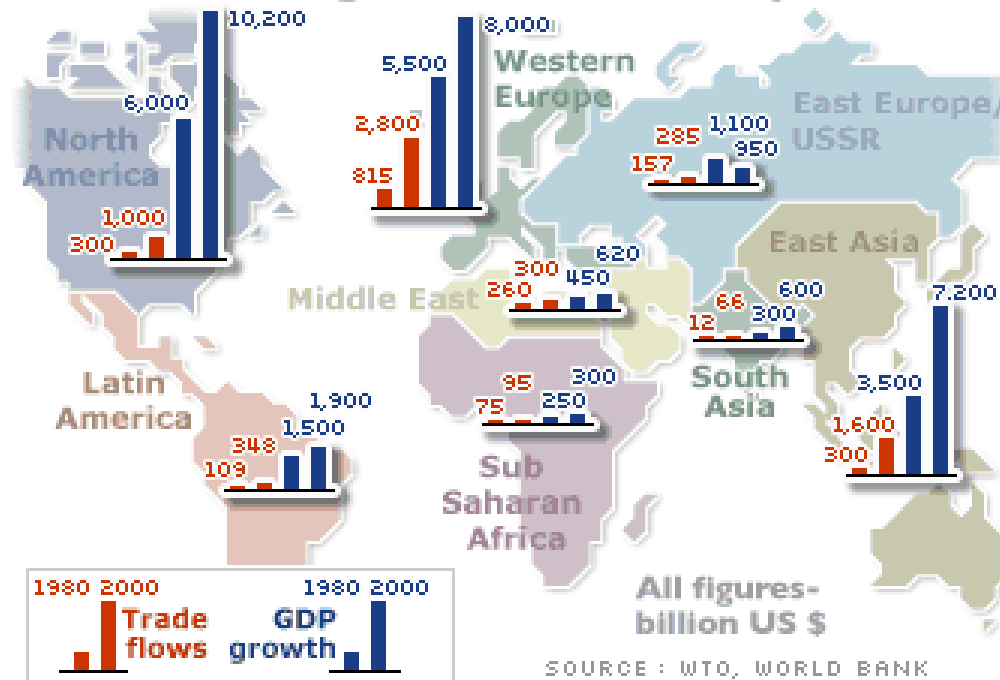
Exports from developing and developed countries, 2005-2030



Source: World Bank simulations with Linkage model.

The more integration, the more growth

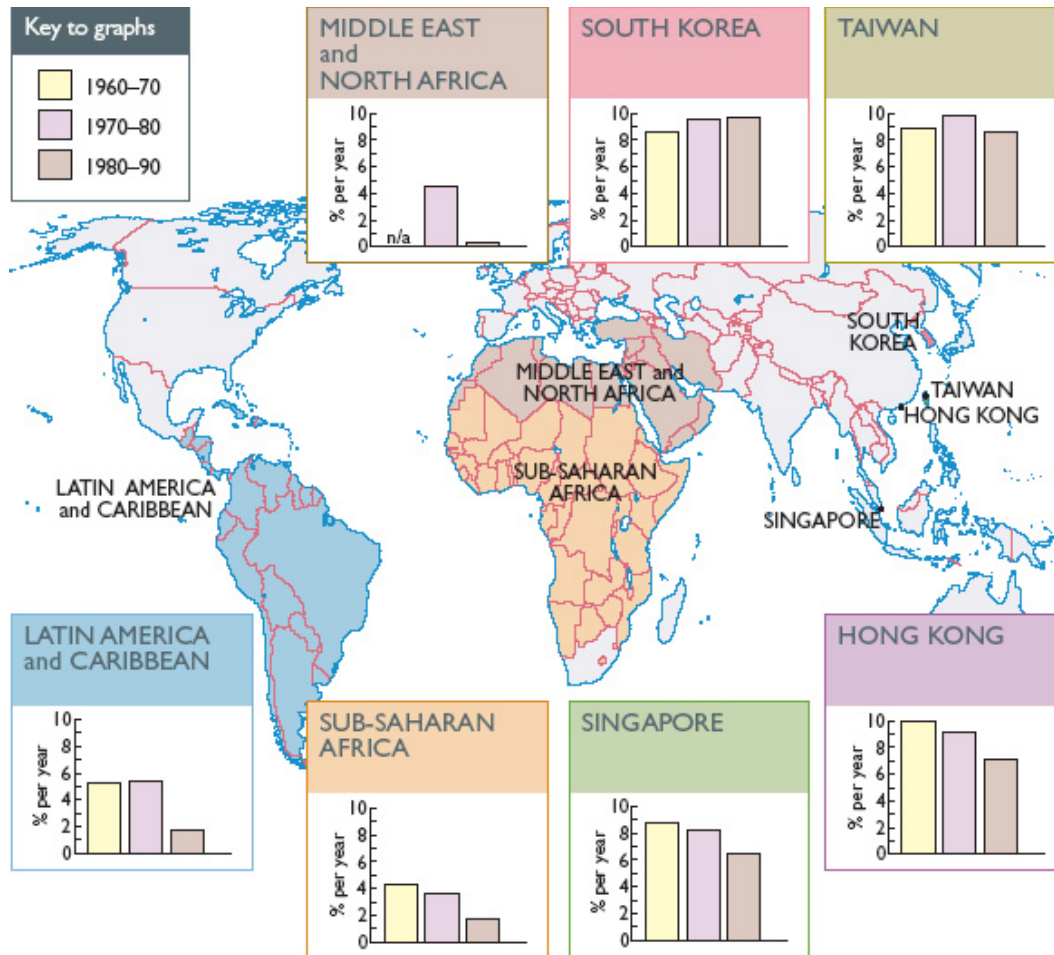
Where trade grows, the economy follows...



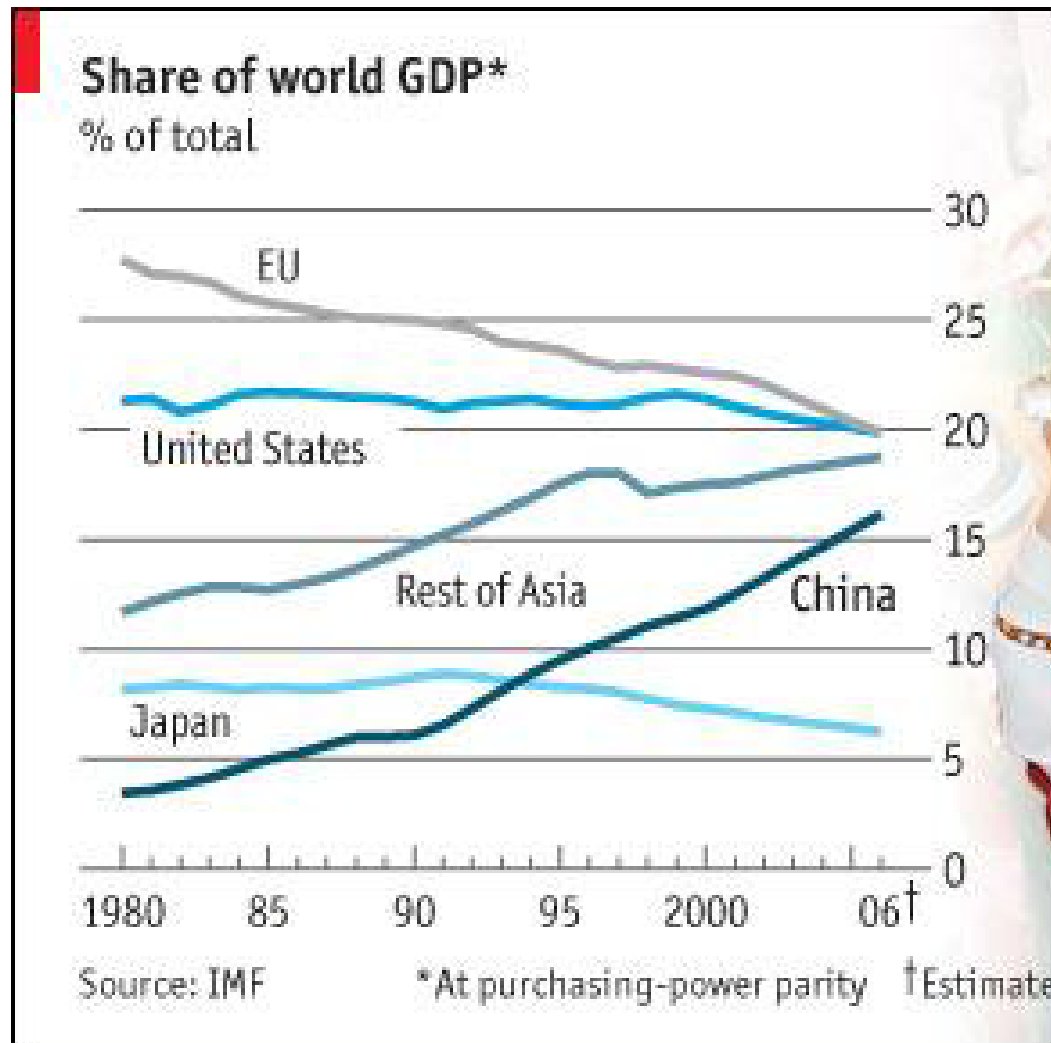
What is common to all theories of development: Accumulation of Capital is the Key

- Theories differ on the BEST way
- Trade?
- Aid?
- Technology transfer?
- State mobilization of capital?
- ISI?
- Growth of a middle class?
- Dependent Development?

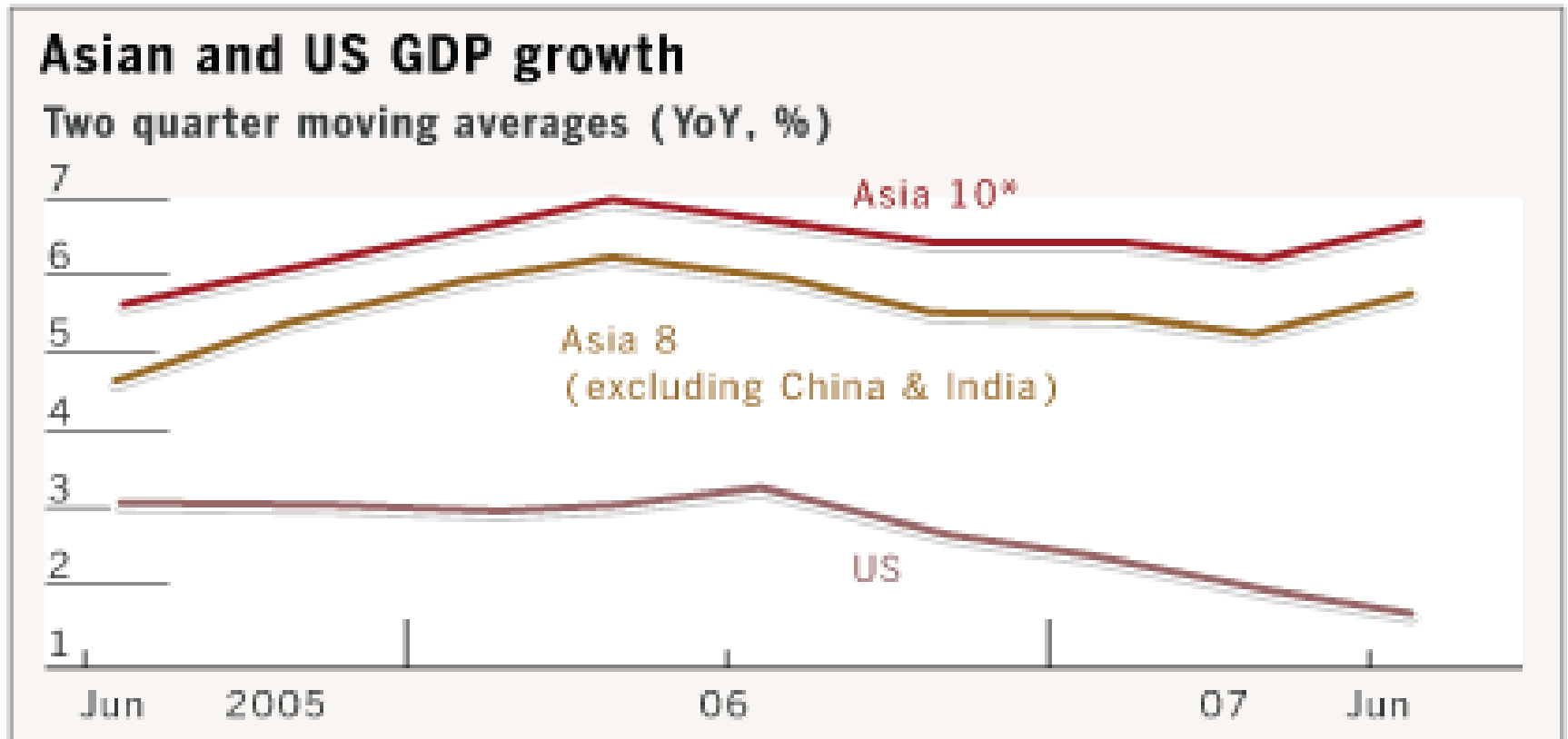
What did Asia do right?



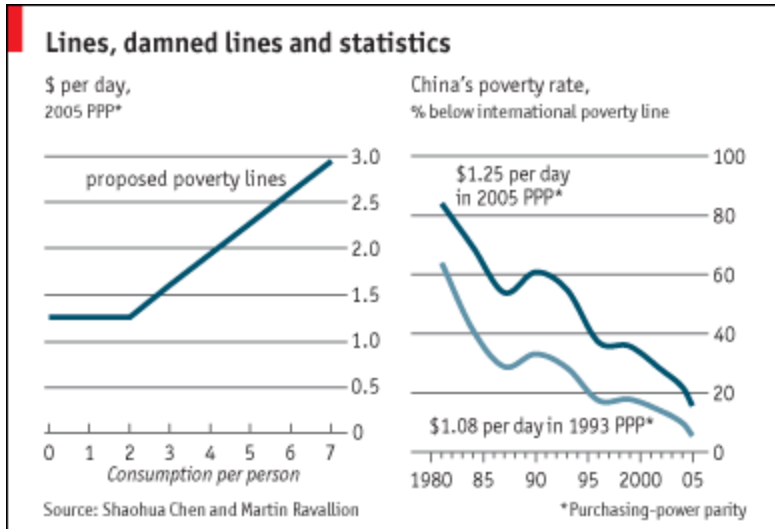
Growing share of World GDP



Asia-US GDP Growth

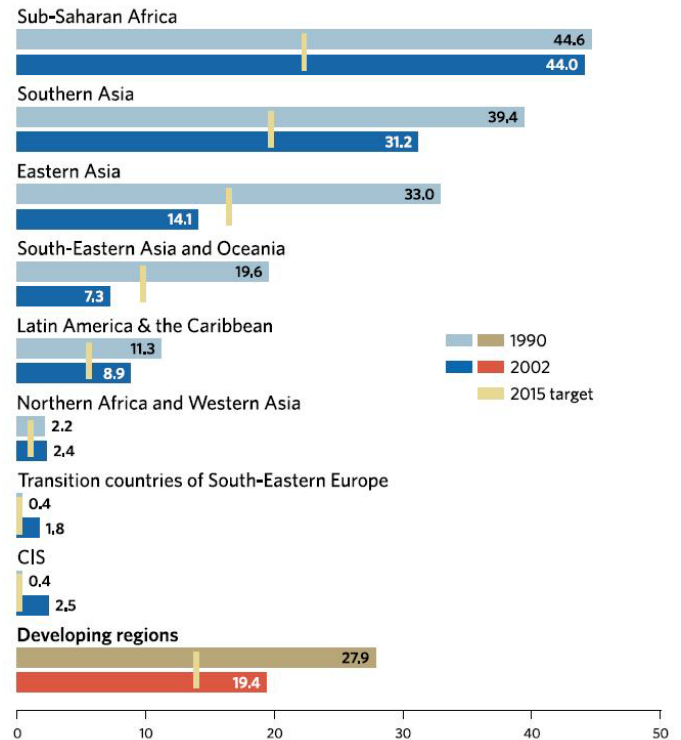


Decline in poverty rate



Asia leads the decline in global poverty

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

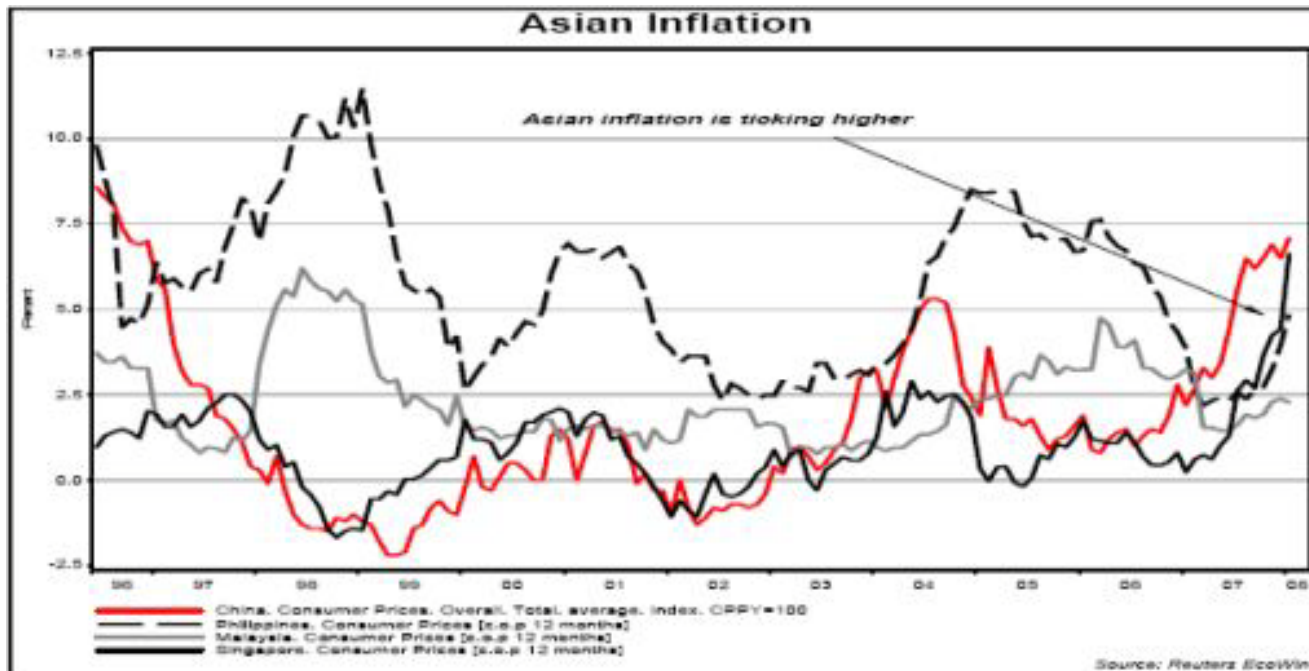


The number of poor rose in South Asia and Sub-Saharan Africa from 1993 to 2002 (\$1-a-day poverty line)

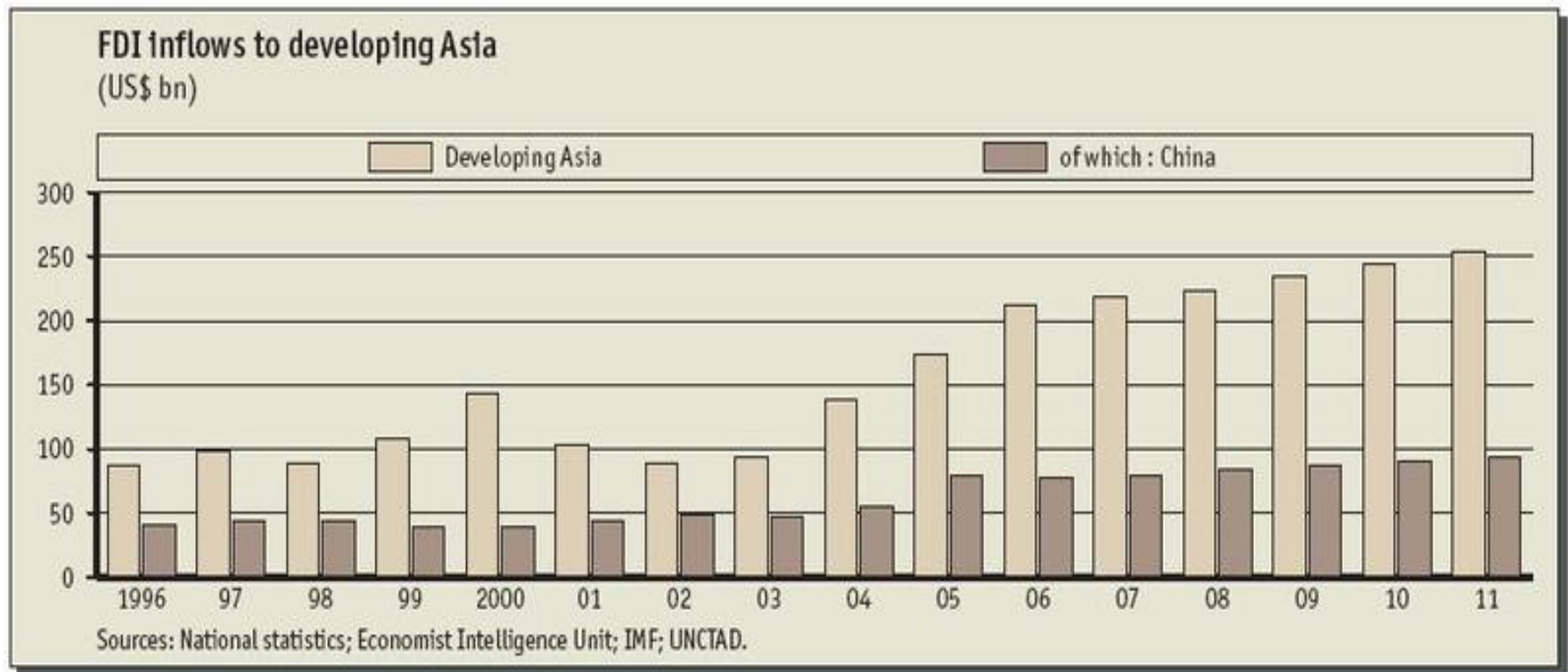


Source: Ravallion, Chen, and Sangraula 2007.

Liberal explanation

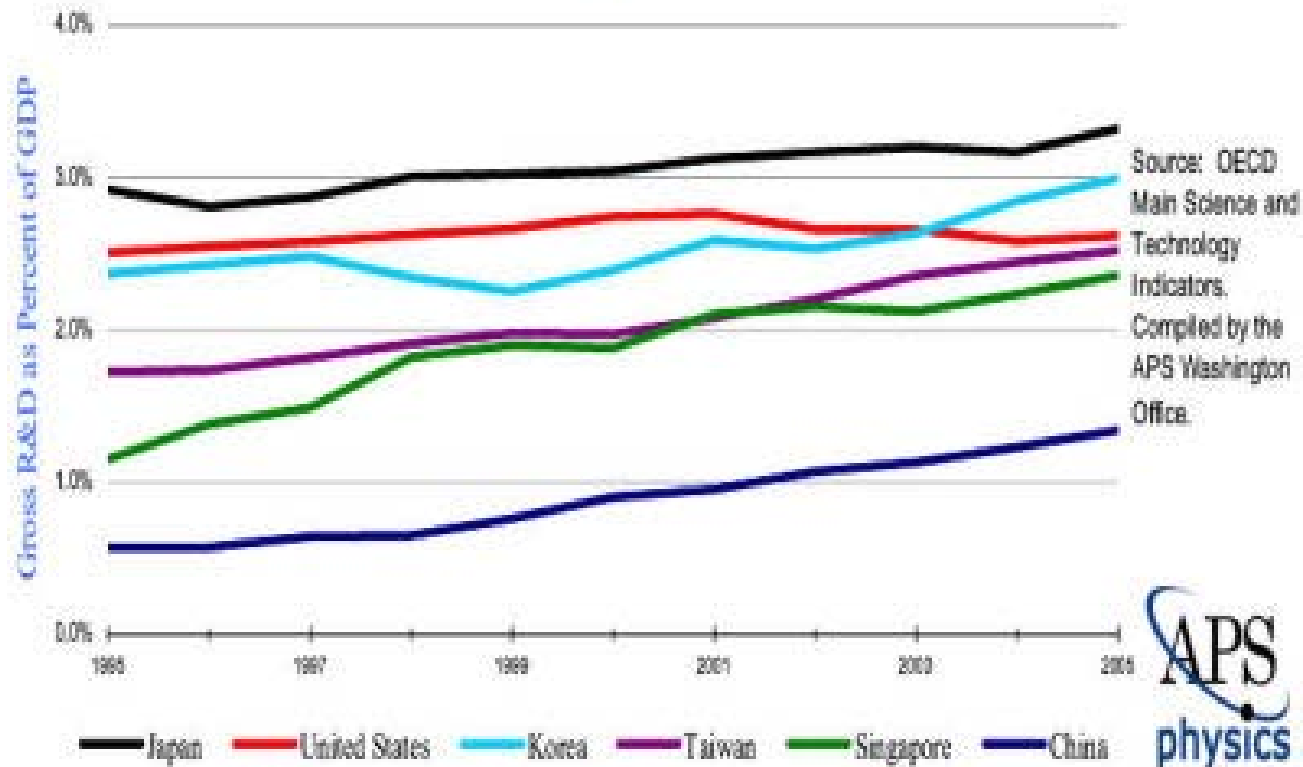


Attracting foreign investment, accumulating capital



The Product cycle?

Asian Countries building their R&D Investments



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