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Thoughts and Proposals on Reviving Development Economics

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Draft paper prepared for the discussion at the UNRISD meeting on
"The Need to Rethink Development Economics",
7-8 September 2001,
Cape Town, South Africa.

Factors Contributing to the Demise of Development Economics

There are three main factors that caused the decline of development economics, especially during the eighties and nineties. These reasons are:

1. As explained well in the other papers in this conference, the hegemony of the neoclassical non-interventionist and monetarist/rational expectations schools in mainstream economics during the seventies and eighties succeeded in removing from the mainstream literature developmental and interventionist approaches to economics. This included the almost successful attempt to kill Keynesian theory and to convert it into a theoretical oddity.

2. The core of development economic theories embodied in a) Lewis', Ranis-Fei's and the dependency theorists' debates on the dual economy, b) works on 'big push', 'balanced and unbalanced growth' and 'import-substitution strategy' by Rosenstein-Rodan, Nurkse, Hirschman, etc. – all did not employ the 'elegant' 'rational', optimizing and comparative statics framework and methodology of neoclassical economics. It is interesting to note that the 'big push' and 'learning by doing' (or 'picking winners' in the technology and knowledge-intensive sectors) theories were able to become fashionable when presented in the neoclassical style of comparative dynamics in the endogenous growth models of Lucas, Romer, Schlifer and Vishny, etc.[1] Another point is that the ascendancy and dominance now of new Keynesian and new institutional theories that allow 'market failures', institutions and governance structures to enter the mainstream is their use of neoclassical models and tools as well as the increasingly fashionable game theory approach.

[1] The methodology mattered, but we must remember that the historical conditions that brought about the rise of the endogenous growth models in the eighties and nineties precisely involved the lack of empirical validity of the traditional neoclassical growth model, especially with the rise of the East Asian 'miracles'. (They had to turn to the disgraced theories of development economics to partly find the right answer.)

3. A third reason which we should not ignore is the entry in the sixties and seventies of so many other topics in the realm of development economics, which merely duplicated existing fields in economics but applying them in a 'Third World' context. Areas and topics in the fiscal, monetary, exchange rate arenas, labor economics, international trade, agricultural economics, education and social sector (population, health, etc.) – just take a quick look at the contents of Todaro's textbook whatever edition – were all included as part of 'development economics'. This 'borrow from mainstream theory and apply to a Third World context' scheme, plus the lack of an elegant neoclassical model (described in no. 2 above), naturally relegated development economics to a status of 'soft' economics indistinguishable from sociology, psychology and other social sciences, and unbefitting of true 'hard-core' scientific and analytical (neoclassical) economics.

On Reviving Development Economics

Based on the above factors, it is clear that the revival of development economics should be outside the paradigm and methodology set by the dominant mainstream economics and towards new paradigms and new methodologies so much needed in modern economics. I would not be so radical as to advocate a complete cut-off from all mainstream practicioners of economics, and a rejection of all their theories and methodologies, since our goal is to eventually become mainstream, and therefore to win over the more sincere and good-hearted of our colleagues. There are also many things to learn from the works of good economists (of different ideologies) who have left some imprint in mainstream economics – Keynes, Hayek, Tobin, and the more modern (and therefore more controversial) economists like Oliver Williamson, Mancur Olson, Amartya Sen, Douglas North, Joseph Stiglitz and Dani Rodrik.

1.- Economics Within a Historical Context: The Role of Institutions, Values, Socio-Cultural Practices and Governance Structures

Let me set down some pre-requisites of the new development economics. Many of the writers of the old development economics had a historical context and took into consideration the institutions, socio-cultural values and practices and governance structures within which their economic model or theories were situated (Rosenstein-Rodan's and Kalecki's Eastern Europe of the fourties and fifties, Hirschman's Latin America of the fifties and sixties, etc). However, these theories were presented in the old development economics literature in a neoclassical fashion – as timeless, static, ahistorical theories not situated in a particular historical context and environment. One can of course kill development theories easily if they are so general as to apply to all cases regardless of institutions, setting, historical environment and the like.[2]

[2] That is why neoclassical theories have to be in an abstract unreal world (of atomistic firms and households, frictionless markets, timeless equilibrium). Once you put some teeth to their theories, such as 'all free market economies fare better

One drawback of some of our own approaches is that we generalize too much. We say a developmental state is the best, while concentrating on the interventions (as the neoclassicals do), and ignore (as the neoclassicals do) the institutional, political, social, values and governance factors in that historical place and time, which may or may not allow the development strategy to succeed.

It would be a big boost to the new development economics if the economics is blended in with the social, cultural, political and institutional setting and environment, so that the possibilities for change and development are clearly defined. In this respect, we need to interact with political science, sociology, anthropology, psychology, the legal profession (yes, we need to work with the lawyers too – which may not be as bad as to have to work with economists who believe that all who do not follow the 'rational', optimizing, comparative statics methodology and who do not do 'probits' and 'tobits' are all lesser beings).

2.- False Dichotomies: Markets vs. Intervention, Market vs. Planning

A corollary to this is that we shouldn't fall into the neoclassical trap of distinguishing markets with everything else, so that we become anti-market in the real sense of not wanting to improve the commodities, labor and capital markets of Third World countries. Thus we see some of us resisting China's or Vietnam's use of better economic incentives on the grounds that they are 'market' devices.

a) Market Situated in an Institutional and Governance Structure: Interventions Needed at the Micro Level

As Polanyi said a long time ago, the market system cannot exist in a vacuum. The quality of the market is only as good as the quality of the institutions and governance structures wherein it is situated and wherein it is guided.

A good occurrence in modern mainstream economic theory is that at long last (thanks to 'transactions costs', 'bounded rationality', 'moral hazards' and other high-falluting terms) it has caught up with what people in the streets long knew -- that markets are imperfect and that markets often fail to distribute resources efficiently and fairly. This would be obvious in the more modern studies on the pharmaceutical and drugs markets, the labor markets, the financial markets (especially after the Asian crisis), and environmental protection. One can include all types of markets – from food to education to housing to futures markets. It is an easy exam question to find market imperfections in all these markets, and to show that these market imperfections are more the rule than the exception. But it is rarely said that the ability to deal with these problems rest with the quality of institutions and governance structures (which includes information dissemination, quality control, fair arbitration, enforcement of contracts, proper punishment and the like). It is inherent for the workings of markets to include interventions and threats of interventions. Ensuring the scales of the wet market are not biased, punishing suppliers who cheat and sell inferior

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than other economies', they fall into the same refutable fate. (Which is why endogenous growth, new Keynesian and new institutional theories are surviving.)

products, consumer group formations and watchdogs – all these are proper interventions in the market and actually determine the quality of the market.

b) Markets Need Interventions and Guidance at the Macro Level

On a more macro level, history has confirmed the theories of great economists like Marx and Keynes who said that the market system by itself does not automatically bring 'equilibrium' and 'full employment'. In fact, uncertainty, changing moods, and varying confidence levels bring to the market a lot of volatility and instability. And global world markets are often the ones that create these volatility and instability, as proven by the East Asian crisis and all other previous economic and financial crises.

Thus to lift demand and confidence in the system, the correct intervention by the state is required. Required as well are strong conflict management capabilities and institutions for social insurance and safety nets so that the system, when beset by crisis, will not descend into chaos and anarchy and produce extreme human suffering. Are the institutions and governance structures capable of delivering these? These are perhaps more basic questions before the identification of economic policies can be tackled.

c) Interventions Needed at the Macro/Global Levels

Going more to the global setting, most practical people, including the more enlightened international trade economists, accept the fact that export markets will offer more advantages if one goes into higher value-added and higher technology products (even promotion of agricultural exports entail a lot of biotechnology and productivity enhancement[3]). This requires critical directing of the export market ('learning by doing') and promotion of R & D.

Again we should not fall into the neoclassical trap of prescribing exclusive concentration either on export markets or the domestic market. The two are important components of the economy. Export receipts may be vital especially for Third World countries that are import dependent and have high current account deficits due to the lack of capital goods and intermediate sectors. Financing foreign exchange requirements via export receipts would be better than financing them by short-term debts or by multilateral loans with tons of conditionalities. At the same time, one sees the folly of relying only on export markets and neglecting the domestic market, as is obvious in the current trend of slowing world exports and possible world recession. We should therefore be at ease with the South Korean 'miracle' of promoting key exports while at the same time protecting and enhancing the domestic market and economy.

On a long-term basis, access to best practices and technology transfer requires some knowledge and experience with key products sold in the international markets. (The modern economic histories of Japan, Taiwan and South Korea attest to this.) Again here, the level and the quality of institutions and governance structures critically determine whether the directing and guidance of the export and domestic markets would be successful or not.

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[3] Some of these may have negative results – as the case of the rise of 'mad cow' disease seems to indicate.

Third World nations' ability to benefit from the export and international markets critically depends on the international world trade setting, which unfortunately is dominated by the developed countries. The attempts of Third World countries to participate fully and benefit from international trade (and not to be adversely affected by it) becomes now a struggle with international institutions such as the WTO, multilateral agencies and the developed countries' hypocritical policies of 'protection for us, openness for you'.

Finally, the East Asian crisis has proved conclusively that capital account liberalization, particularly to short-term flows, is akin to opening your home to drug pushers. One need not argue whether we should supervise or regulate them (akin to the financial supervision and regulation strategy of the IMF) or just ban them outright. But again, for the unfortunate countries that have unwittingly opened up their capital accounts (the Philippines, Argentina, Russia), it would again depend on their institutions, governance structures and political will whether they can re-impose controls and deal with potential vengeance from the multilateral institutions and developed nations, or whether they would need regional and international efforts to transform the global financial structure.

Given these views of markets in a historical and institutional setting – from the micro, macro and global perspectives -- intervention, directing and guidance of markets become inherent in their efficient workings and operations. Non-intervention in markets can only have meaning in the most anarchic and chaotic sense. But the quality and soundness of these markets and related institutions (and their possibilities of contributing to economic development) depend critically on the quality of social, political and cultural institutions and governance structures.

3.- The Content and Methodologies of the New Development Economics

From the previous discussions we can propose some important topics to be covered by the new development economics

a) Global and Regional Institutions and Environment

The first set of analyses proposed are studies on the global and regional (supra-national) institutions and setting which constrain or facilitate the growth and development of Third World countries. Of course, the constraining factors are more numerous and dominant. Analyses of the ideologies and strategies of multilateral institutions (IMF, WB, ADB, etc.), UN agencies (UNCTAD, UNDP, ILO), the international financial architecture and the processes guiding short-term and longer term capital flows, patterns of world trade and the impact of global and regional trade and economic blocs (WTO, AFTA, NAFTA, European Union, Organization of African Unity, G7 and G8, etc.), bilateral institutions – all these need to be analyzed on how they affect the possibilities and room for maneuverability of Third World nations. Normative and prescriptive analyses towards a new economic world order and a new global financial architecture are necessary components of this set of topics.

b) Development Theories Applied to Particular Setting and Context and Linked to Institutions and Governance Structures

One can go back to the grand theorizing of the big push, balanced and unbalanced growth and other development theories. But they should be situated in a setting that facilitates or constrains the development processes via the historical institutions, governance structures and socio-cultural practices, and via the possibilities or constraints of the current globalization processes. Sectoral analyses (social sectors, international trade and capital flows, agriculture, labor, industrial organization) all can be studied again but more clearly situated within the possibilities and constraints of a particular level of development and socio-political and cultural institutions. Thus, these sectoral analyses would differ immensely from the mainstream theories in those fields and would not just be replicating mainstream theories.

The inclusion of historical conditions, institutions and governance structures would also give true meaning to the structural transformation aspects of the development processes. This is juxtaposed against the stabilization and structural adjustment processes imposed by the multilateral institutions, which are ahistorical blanket prescriptions and conditionalities that ultimately become cruel and inimical to the interests of Third World nations.

c) Social and Distributive Policies as Economic Empowerment

Instead of dichotomizing economic growth and development from social and distributive policies (or human development policies), the latter should be integrated as a crucial component of the economic development scheme. This component should be interpreted as the economic empowerment of a people's sector (which can replace the traditional concept of the household), and developing its capacity to be competitive in the factor, capital and goods markets. The huge informal and self-employed sectors will also be key areas to analyze here. Even mainstream theories in human capital, endogenous growth[4], and social capital can be used to advance these analyses, except that they should again be more rooted in the historical context, institutions and structures of the social formation being analyzed.

d) Links With Mainstream and Non-Mainstream Economics

The possible areas of dialogue and interaction with mainstream economics is clear. Particular sectors and enlightened researchers in the Keynesian, new Keynesian, new institutional economics, economic history, gender and natural resource economics in mainstream economics can become members of this movement, especially those that link their theories directly with the institutions, governance structures, socio-political and cultural practices of the social formation being analyzed. They should also be encouraged to move away from static equilibrium or equilibrium path analyses that have no place for history and time, as well as to reject frameworks that pit markets with interventions, and markets with institutions.

And of course, there are so many other non-mainstream thoughts and methodologies to absorb. Some of the great economists or thinkers that have been discarded by mainstream economics and should be reintegrated to our

[4] We said earlier that much of endogenous growth theories were simply borrowed from the original development economics theories.

new development economics are Marx, Schumpeter, Myrdal, Kalecki, Joan Robinson – just to name a few. The new development economics also provide fertile ground for interdisciplinary work and researches creating potentials of a new economics incorporating Keynesian, Marxian, structuralist, sociological, psychological and political theories, new institutional theories, and post-modern insights (as well as post-post-modern critiques).

Our new development economics, unlike the traditional mainstream economics, should be able to incorporate various methodologies including the mainstream's comparative statics and game theoretic approaches in deductive reasoning and econometric analyses and 'probit'/'tobit' regressions in empirical validation. The importance is a sincere effort to get at the essence of development in a historical and institutional setting.

But these methodologies can also be diverse and fertile including more acceptance of non-traditional methodologies such as Marxian class and beyond class analyses, historical analyses and empirical validation via case studies, focus group discussions and information retrieval from key informants. Much of the best works in the new institutional school (Williamson, Olson, Stiglitz, Rodrik) actually use case studies to illustrate important points. This suits very well the institutional and structures-sensitive approach we have proposed in this paper.

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