This book is in draft and is based mainly on the teaching materials of the two authors in the UK and Portugal respectively. it also reflects extensive advisory work in developing economies over many years. The materials on this web site are preliminary versions of the component chapters of the book which are still subject to checking and review. Use of the materials is welcome subject to this health warning and appropriate acknowledgement of source. Comments on the materials are also welcome.

PART ONE

Establishing a Common Platform of Concepts and Facts

This first Part of the book is in FIVE chapters and has the following objectives:

- To set out the broad content of the book and explain a few of the main difficulties that we confront in studying "development" (Chapter 1).
- To familiarize readers with a common platform of basic concepts and terminology (Chapters 1 and 2).
- To provide a narrative description of four major propositions – or "building blocks" - that we use to discuss the process of economic development and how these interact (Chapter 2).
- To introduce the main data sets and indicators that are now commonly used to assess progress in the fight against global poverty (Chapters 2 and 3).
- To provide readers with a common platform of facts about the present day gaps in living standards between rich and poor countries in the modern world and the problems of assessing these accurately (Chapter 3).
- To provide a common understanding about the historical trends in living standards (and their divergences) in (i) the very long term since AD 1000 and (ii) in the modern era since 1950 and also to introduce the Millennium Development Goals as the most recent basis for assessing the progress of "development" (Chapter 4).
- To see if we can uncover some basic patterns in development across a wide range of countries that might then be used to evaluate the relevance of the growth models discussed in Part II (Chapter 5)

CHAPTER ONE

INTRODUCTION

1.1 Scope of the Text

As noted in the Preface this book attempts to provide an orderly synthesis of an enormous diversity of opinion in the economics literature about both the *diagnosis* of the causes of development and under-development and the prescriptions about the appropriate *solutions*. Because of the multiple audiences that the book targets – in both advanced University study in different regions of the world and in parts of the practitioner community – the book presents both descriptive materials about the nature of the development divide, and a review of some main parts of the technical economics literature –theoretical and empirical - that is designed to penetrate the causes of under-development and identify the appropriate policy prescriptions that are needed to raise countries and their people out of poverty. The discipline of economics is the central focus of our attention and justifiably so since economics pervades almost all aspects of the development debate. However, the book does recognise quite frequently the unquestionably important insights coming from the other main social science disciplines such as sociology, politics and above all from history.

The literature that is encompassed in the book is mainly from the past-War period of the past 60 years. As Gunnar Myrdal (1968 pp 8)) noted in his epic study of Asian development, before the War there was little real interest from social scientists other than cultural anthropologists in what he called “underdeveloped” countries. Thereafter a variety of political impulses and not least the ending of most colonial regimes, massively raised the profile of the topic and led to the mountain of development economics and other social-sciences literature that we now perceive. However, this is not to deny that there are many important antecedents to the post-war literature. The book does provide some backward looks to this in relation to some topics.

As is also explained in the Preface the post-War years have seen at least three significant consensuses in the economics profession about both the technical approaches needed to study development economics and about the types of solutions to underdevelopment that that study was likely to suggest. These are the so-called “high development theories” in Krugman’s (1999) terminology in the period through 1980; the ideas of the Washington consensus in the subsequent 15-20 years; and the far richer but uneasy post-Washington consensus of Joseph Stiglitz (1998) et al in the period up to the present day. The analytical approaches and styles of these three great paradigms of the problem of development are fundamentally different from each other. The word “modern” in the title of this book might be interpreted to suggest that its focus is narrowly on the most recent of these three broad paradigms. But a more helpful approach – and the one adopted by the book - is to try to explain the evolution of ideas across this span of time and idea and interpret modern best-practice as a distillation of bits of all three rather than as a linear evolution from the oldest to the newest.

The case materials for the book all come from the collective group of countries and peoples in the continents of Africa, Asia, Latin America, including the Caribbean, and some parts of Central Europe and the former Soviet Union where the bulk of the world’s poor and its poorer countries are still to be found. The landscape here is both depressing and also dynamic and in some sense promising and exciting. 30 years ago there was considerable anxiety about the stubborn nature of underdevelopment and poverty in countries such as China and India. Now there is some significant evidence that these two great nations are moving rapidly to close the development gap with the richer parts of the world. China is already the second largest economy in the world and, on some estimates could overtake the USA within the next 10 years. The book has tried to be cognisant of this positive dynamic and not get too sucked into the generalised mood of pessimism about the rich: poor divide that characterises much of the popular debate.

1.2 The Structure of the Book

The book is presented in Five Parts corresponding to different types of substantive material and also to different degree of technical difficulty.

This Chapter and the remaining four chapters of Part I have one simple objective. This is to establish a common platform of Concepts, Definitions and Facts that will help readers to find their way through the remainder of the book. So although the materials of Part I will be easy to follow for all of our target audiences, those different types of reader are all encouraged to at least review the materials before proceeding. A subsidiary objective is to put forward ideas which, for the time being avoid drawing the book into any of the major controversies about development economics. To the extent that this can be achieved, it can create some common ground of understanding of a few basic points among widely different readerships. Don't worry the controversies will come soon enough.

Part II focuses on the sub division of development economics that deal with the formal economists' statements about Growth. This branch of the subject addresses the main potential sources of growth and the variety of factors that can conspire to constrain and slow down growth rates. It also deals with the highly pertinent questions about the conditions that result in the convergence (or non-convergence) of the income levels of poor and rich countries. This part of the book is necessarily more technical and is pitched at a level which should be accessible to the senior undergraduate and to the early graduate students targeted by the book.

Part III shifts the techniques of analysis from the highly aggregative to the explicitly micro. The analytical techniques of Growth Theory are inherently aggregative in nature – much of that theory engages the fiction of a single representative commodity that can be used either for consumption or investment. By contrast, Part III of the book explores a class of microeconomic techniques that enable us to analyse instead a wide range of different markets for individual commodities and explain how these markets connect together to create various outcomes for the whole of an economy. The examples include selected discussion of the microeconomics of agricultural markets, of labour markets and of population. The discussion of Part III also provides the opportunity to explain the theoretical reasons that mainstream economists have long used to justify the interventions of governments in the development process. At this stage too it is convenient to explain some of the multi-disciplinary literature (especially the politics-economics interface) that helps us to understand the manner in which governments succeed or fail with their interventions.

Part IV of the book then goes to an intermediate level of aggregation and uses the main aggregated variables such as Consumption, Investment, Government deficits etc. to explain a variety of the critical issues of Macroeconomic management that affect the prospects for successful development. This Part of the book focuses mainly on the burning policy issues in macroeconomics including the appropriate management of monetary and fiscal policy as influenced by IMF programmes, the underlying causes of the developing country financial crises of the 1990s and the new millennium that radically worsened the situation of the countries affected at least temporarily and the manner in which fiscal constraints bear down on social objectives such as the achievement of social and poverty-targeted spending programmes.

In the remainer of this short chapter we try to communicate just a few of the reasons why " development" is such a complex business. This is for many reasons – the next three sub-sections discuss just three.

1.3 What do we mean by Development?

Agreement on what we mean by a "fully developed economy" is elusive and very controversial. Although simple definitions based on income levels are central to the analysis conducted by most economists, they are easily criticised. Almost everyone accepts that a high level of material prosperity – as indicated by levels of income or consumption or by the ownership of assets - is one central defining feature. This definition enables the World Bank and others to identify 80 economies out of a total of 212[1] in the world as "high income" and by implication "developed" in some sense. Included among these high income countries are 32 members of the OECD including two erstwhile lower income economies (Chile and South Korea) and six countries that have been in transition from the socialist systems of Eastern Europe (Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia). The same World Bank data now (2016) recognises just 31 low income countries (per capita income less than $1,045 per annum but 51 low middle income countries (income per capita of $1,045 to $4,125 per annum).

But how does one factor in other less easily measured aspects of a society's progress or lack of it? What if the material prosperity is shared increasingly unevenly as indeed it is in many of the 24 countries; if it is accompanied by squalor and congestion in parts of major cities; by the destruction of great swathes of countryside and rare habitats; by a decline in moral standards, by obesity in more of our young people, by increasing crime, suicides, a lower respect for basic moral standards and more visits to psychiatrists; by an increasing pressure on non-renewable resources – the list of caveats is long and growing and we consider some of them in Chapter 2[2].

Rather than try to define "development" it is probably more helpful, as is the case with most complex objects e.g. the elephant, to list some of the defining features that enable most people to recognise it. The economics literature identifies a number of such features- buzz words - that are widely associated with most people's perceptions of development or its antithesis namely under-development.

- Central to these is the idea that development requires the ***growth*** of the economy – normally measured by an income or production aggregate such as total GDP or GDP per person. Without some growth most of the desirable improvements needed in poor countries are hard to achieve

- This is often complemented by some idea of ***modernisation*** – indicated by how closely institutions, physical infrastructure, and modes of behaviour including those of governments are approaching those seen in countries that are already developed, typically Western industrial economies such as the USA, France or Britain.

[1] World Bank, *World Development Indicators*, 2016.

[2] The manner in which "development" links up with people's perceptions of their own "happiness" is one of the newly emerging fields of multi-disciplinary research. In spite of mind-boggling gains in income, longevity, health, car ownership, overseas vacations etc. the average person in the more developed countries now turn out to be no happier than were their grandparents in the 1940s. If there has ever been a "golden age" it is here now right now– but we do not seem to appreciate it. Economists find it difficult to explain this paradox.

- Increasingly perceptions about development also include the availability or otherwise of ***basic needs*** such as adequate nutrition, shelter, clothing, water, and physical security. The concern with severe ***poverty*** as a defining feature of under-development derives from the belief that the extremely poor will not have sufficient access to basic needs.

- In the more recent past –and especially with the escalation of concerns about climate change - concepts of ***sustainability*** have been layered on to the other elements of the implicit definition. The question here is whether today's standard of living can be expected to be available to future generations or are resources being depleted in a manner that will make future incomes lower.

- Finally, economists are increasingly recognising an element in the make-up of development that political scientists have seen for longer namely the quality of ***governance*** and the even-handedness (or otherwise) of the treatment of individual citizens of a country. Governance is widely linked in many people's perceptions with the concept of equality and ***inequality***. It is difficult to think of a country as truly developed, in spite of a high average income, if the governance of the country's wealth and institutions enables income, and other "rights" to be enjoyed disproportionately by a small elite.

Box 1.1: Definitions of Development are Controversial

Many arguments about "development" hinge on how one perceives the various defining features listed in the text. Some of these features are unambiguously desirable. Obvious examples are the reduction of poverty, and the improvement in the provision of basic needs to more people. The older literature which Paul Krugman (1999) labels "high development theory" was clear that development involves profound historical, economic and social change and that the transformation of a "traditional" to a "modern" society is the very essence of the process. But the more recent literature including the post-Washington consensus is far less categorical and specific about this.

Furthermore, several of the elements that are listed in the text can be, and have been, perceived to have negative as well as positive implications. This has been true in particular of the two elements of the definition namely *growth* and *modernisation*. The colonial history of most of today's developing countries makes it easy to see why concepts like "modernisation" are argued by some critics to be synonymous with a set of standards laid down by Western (colonial) authority, on Western terms and with scant regard for the culture, religion and social traditions in the countries themselves. This view is characteristic of much of the literature that analyses the historical record on colonialism. It also persisted after most countries gained their political independence in the second half of the 20th Century. It was manifested very forcefully in the literature of the early post-colonial years (1960s and 1970s) and especially in the so-called "dependency theories" promulgated in particular by Anders Gunder Frank [1967] and in "structuralist theories" promulgated by Latin American and Caribbean authors such as Prebisch [1950], Furtado [1964 and 1969] and Dos Santos 1970]. The essential idea in these branches of the literature was that the problems of development stem fundamentally from the nature of the involvement of poor countries with the global trading and capitalist system. The solution was for such countries to weaken the grip of that system via trade barriers, controls on multi-national corporations and in general by adopting generally more independent approaches to their economic management.

These ideas have faded from prominence in the mainstream economic discussions of the recent past. Although the legacy of the dependency and structuralist thinking of the early years can be detected in the far more disparate ideas of today's anti-globalist movements, there is little or no support for these extreme propositions in today's mainstream economics. Indeed there is a remarkable consensus amongst most professional economists that economic autarky is invariably a disaster for those low-income countries that espouse it. The world no longer has any truly autonomous communities of any size. In addition it has become increasingly evident that some poor countries have been able to make huge economic advances since the 1970s by engaging actively with the international trading system while still retaining many features of their individual cultural, social and political distinctiveness (China and South Korea are notable examples). This does not mean that the international systems of finance and trade are benign and even-handed as between the powerful and the less powerful countries. Clearly low-income countries need to organise their participation in these systems with care.

Today's much greater emphasis on poverty-alleviation as the *sine qua non* of development has been a helpful because it has clarified that the other defining features (including growth and modernisation) are means to an end and not ends in themselves

In putting these defining features together, the analogy with the elephant is quite a useful one. We would not dream of defining an elephant merely by reference to anyone of its unusual long proboscis, its very large ears, or its exceptionally horny skin. None of these features taken on their own would represent an unambiguous definition of such a complex animal. So it is too with development. Growth and modernisation may be important aspects of "development" but in the absence of information about the other defining features listed above – basic needs, poverty, sustainability, governance and equality - it would be premature to know whether any particular country was truly "developed" or still moving in that direction.

Hence we need to look carefully at all these aspects as we proceed through the analysis of the book. Since much of the published economic analysis relies heavily on the growth concept (particularly the growth of GDP) the manner in which this correlates with the other defining features listed above is also a frequent point of reference.

1.4 Recognising the Disparities in Under-Development

A second problem is that there are now 212 separate national economies in the world with some degree of sovereign authority over their futures[3]. But these economies display substantial differences in aspects of culture, size, history, location, institutions, ethnicity or in some other factors. Those amongst them that are classified as "not yet developed" include tiny atolls in the South Pacific such as the Marshall Islands, American Samoa and Palau with populations less than 100,000 and total domestic production (GDP) smaller than that of many US or European medium sized companies. In fact there are around 20 countries in the World Bank's list of 212 countries with populations less than 100,000 persons. But the list also includes the large and highly populated states of Asia mainly India (1,295 million persons in 2014) and China (1,364 million persons) that together account for almost half the people of the "not-yet-developed" world. China that as recently as 2006 was classified as a "low-income country" (now classified as "high middle-income") is now seen as a global powerhouse of an economy that has global economic power and influence that is rapidly coming to rival that of the USA.

Many collective adjectives have been used at various times to bring some commonality to these disparate economies: less-developed, developing, under-developed, emerging, third world all have their advocates. However, this terminological choice is but a small part of the problem of modern development economics and should not be allowed to take up too much of our time. From hereon, this book will arbitrarily adopt the term "**developing**" as its collective adjective of choice[4].

[3] This is the number identified by the World Bank in its main statistical publications of which we will make frequent use.

[4] The literature of the 1960s and 1970s contains huge amounts of terminological debate over concepts such as the "third world", the " non-aligned world", "less-developed countries" "under-developed countries" etc. This present book eschews discussion of this largely on the grounds that the diversity between individual or groups of

The more substantive point is that the economics of relevance to these disparate developing economies cannot be wholly the same for all of them although there is much common ground. Only the more cavalier of analysts would bracket them all together. We do so ourselves only for a limited range of purposes. For most topics in the book it will be helpful to classify countries into groups such that the differences *within* groups is significantly less than the differences *between* them. This avoids a methodology bogged down in a bewildering number of special cases. But the downside is that even *within* particular country groups, important differences will sometimes be suppressed by the classification. Case examples are used to try to limit this risk.

The country classifications used in large part of this book are introduced later in the next Chapter. As an appetiser Boxes 1.2 and 1.3 introduce two country groupings that are relatively new entrants to the development debate and that figured marginally if at all in the textbooks of a decade ago. These are the Heavily Indebted Poor Countries (HIPC)[5] countries and the "Transition" countries. A cluster of poor countries that are broadly coterminous with the HIPCs has recently featured in an important analysis of the countries containing the poorest one billion persons on the planet by Paul Collier (Collier (2007).

1.5 Solutions to Under-development Proliferate

A third source of complexity of development studies concerns the proliferation of solutions and the low cost of putting these forward. Many sensitive individuals and organisations worry about the inherent unfairness and even immorality of a rich world containing still so many extremely poor people.

Box 1.2: HIPCS – a Laboratory for Understanding Deep Poverty

The 41 (HIPCs) are crucial to our story because they represent in extreme form the problems of the more desperately poor countries of the developing economies. The 750 million people in these countries are a significant part of total world population: some 12% of the total. Their situation reveals much of what we need to know to appreciate the human consequences of a chronic failure to develop. These consequences include grindingly low incomes, malnutrition, low life expectancy, high incidence of avoidable illnesses, high child mortality, poor provision of health, education, water and other basic needs.

The unsustainable debt levels that define the "HI" in the HIPC acronym also reveal much about the *macroeconomic* dimensions of abnormally poor countries: low tax bases confronting large requirements for public expenditures result in unsustainable fiscal deficits, high debt service ratios, even when the loans are provided on highly concessional terms, and great instability of inflation and exchange rates that complicate such efforts as are made to develop new forms of productive activity.

Significantly 25% of the total population of all the HIPC countries can be found in two countries namely Nigeria and The Democratic Republic of Congo (formerly Zaire), that are acknowledged to benefit from huge endowments of natural resources. This is an early reminder that natural resource endowments, as with plentiful capital do not guarantee development and high income.

Of course severe poverty is present in numerous other developing countries besides the HIPCs including in the two giant Asian economies of India and China. However, the severity of the problems in the HIPCs make them a useful laboratory of study for several topics in this book.

developing countries is too complex to succumb to any simple categorisation. However, for an extended discussion of these matters, the reader is referred to Potter et al (2004) especially Ch.1.

[5] for a overview of the HIPC initiative the reader is referred to the web site of the IMF www.imf.org. A paper by Anthony Boote and Kamau Thugge (1997) provides a useful summary of main issues

They worry for a variety of moralistic, humanitarian, religious and practical reasons. Many of them proffer solutions to the development problem based on their own particular mandates, interests, concerns, and often from a platform of celebrity (e.g. Band Aid and food relief and Bono and debt relief). The latent anger evident in many of the pronouncements of persons such a Bob Geldorf and the *Making Poverty History* campaigners reflect an oft-stated view that rich countries can relatively easily choose to relieve the poverty in developing countries if only they would find the political will to do so : through more generous aid, less-restrictive trade policies etc. Paul Collier labels this form of advocacy - *"development buzz."*

Well-informed NGOs such as Oxfam and Third World First also invariably argue for more official (government-provided) financial aid; faster relief of HIPC debts and easier trade access into western markets for developing countries exports. Human rights lobbies such as Amnesty International argue that development proceeds better in societies characterised by democracy and freedom than by autocracy. Population lobbies invariably emphasise an improved awareness of contraception techniques and often the provision of state subsidies to increase usage. Famine relief agencies lobby for more transfers of food to poorer countries. The appeal of all these various solutions to the problems of development and poverty is strong and generally very positive in raising awareness.

But too often these solutions are based more on strong intuition and a deep sense of injustice rather than on sound analysis and the hard evidence to confirm it. The evident attractiveness even "goodness" of these proposed solutions can often be a false friend to the serious student of development economics. Their importance in practice is often of a lower order than the proponents would claim and their justifications are often weaker or more dependent on various un-stated pre-conditions.

Box 1.3: Transition Countries – A Laboratory for Understanding the role of Institutions in Development

The 30 transition countries provide a useful laboratory for study but for different reasons. These countries comprise mainly the European countries that emerged in 1989 from up to 70 years of domination by the Soviet economic system, plus two important Asian countries namely China and Vietnam that are now shedding socialist systems of economic management for their own reasons. The study of these 30 countries – some such as Russia, China and Ukraine being powerful industrial as well as nuclear nations – adds a new dimension to the traditional study of development economics. Above all it provides important new insights into the role of key institutions in the development process.

Economists generally were wrong-footed by the failures in the 1990s of many apparently sensible market reforms in Russia and the other European transition countries – examples include currency convertibility, trade liberalisation and the privatisation of former state-owned industries. Increasingly these failures have caused economists to extend the literature on the roles that must be played by key institutions in a well-functioning market economy. See above all the writings on this by Stiglitz such as Stiglitz (1996). This new research has also shown how relatively under-emphasised the role of key institutions such as land registration, commercial courts and bankruptcy have been in those many developing countries (the majority) attempting less dramatic adjustments of their systems of economic management than has the USSR.

For example, more *development aid* may be desirable but the economic effects of the aid already provided have often been limited. See for example the strong attack on the maintained assumptions of the aid lobbyists by William Easterly (2006) and the 2015 Nobel Laureate Angus Deaton[6]. African countries like the Congo and Zambia that have had bucketfuls of aid for many years remain worryingly poor (see Chapter XXXX). *Subsidised contraception* is but a small part of the complex processes that have been shown to reduce population growth to more sustainable levels (Chapter XXXX). International *food aid* can sometimes play a role in major famines to support well-designed local food relief arrangements, but it has precious little part to play in relieving the endemic malnutrition which is the deep-rooted problem facing HIPCs and other very low income countries. *Debt relief* does not offer a sure-fire boost to improved living standards: that can only come from relieving some of the root causes that led to excessive debts in the first place. The countries that have enjoyed the most debt relief since 1980 are the ones that most need debt relief today! (Chapter XXX). Above all there is no hard evidence or credible economic mechanism through which the rejection of “globalisation” can improve the lot of the world’s poorest.

At this “getting started” stage readers may find it helpful to think of development as having something in common with the multi-digit code to unlock a safe. Setting one or two of those numbers correctly is crucial to unlocking the safe (development). But one or two correct numbers open nothing if the other numbers in the combination are incorrect. Generous aid (or debt relief) without good policies, or good policies without the right institutions are just two of the many development “solutions” that have often failed to open the safe!

So while the study of development economics can certainly be combined with a moralistic attitude to the tragedy of underdevelopment, the reader should try to avoid a premature buy-in to some or all of these popular solutions however much they may speak to you own moralistic and humanitarian priors. One key purpose of the economic analysis presented in this book is to clarify when, how and with what side-conditions in place, the popular mantras of development activists can really play a part in actually improving the lot of the world’s poor. As Collier (2007) puts it …“don’t look to *“development buzz”* to formulate such an agenda (i.e. to relieve the lot of the poorest one billion): it is at times a headless heart” …

[6] Angus Deaton , The Great Escape: Health, Wealth, and the Origins of Inequality

and "it has to keep its messages simple, driven by the need for slogans images and anger" (pg 4)

References:

These follow the last chapter of Part One.