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(出版者 / Publisher)
法政大学経済学部学会
(雑誌名 / Journal or Publication Title)
経済志林 / The Hosei University Economic Review
(巻 / Volume)
71
(号 / Number)
4
(開始ページ / Start Page)
267
(終了ページ / End Page)
284
(発行年 / Year)
2004-03-05
(URL)
https://doi.org/10.15002/00003224

Note

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Introduction

John R. Hicks, the first Nobel Laureate in Economics, used to say in his later phase that the discipline of economics should be located "at the edge of history and theory". His famous *Theory of Economic History* was a result of this assertion (Hicks 1969). As is well known, Alexander Gerschenkron, a great economic historian, and Peter Bauer, a notable development economist, wrote a long critical book review (Gerschenkron 1971; Bauer 1971). These are really stimulating discussions when we think about the historical evolution of development ideas. The core of discussions was related to the subject of rising market economy in the developing countries. And this is an episode that shows an intimate relationship between development economics and economic history at that time[1].

For the development economists of 1950s and 1960s, historical studies were indispensable necessities. However, since the latter half of 1970s, resurgence of neo-classical economics in the field of development economics drove away historical studies. And the new development

1) See Gerald Meier's appraisal of Hicks as a development economist (Meier 1990).

economics that stresses the "policy and theory" took the place of the old development economics that were located "at the edge of history and theory".

However, a variety of critical assessments against the neo-classical approach appeared during 1990s. Among others, the most notable one was the resurgence of historical studies. This small note is to try to assess development economics from the viewpoint of "at the edge of history and theory".

1. Early Development Economics and Studies of Economic History

In the epoch of the early development economics that was prevalent from the end of the Second World War to the late 1960s, influence of economic historians was substantial. The early development economists who advocated the "structuralism approach"[2] started their arguments with the premise that economic development meant industrialization. For them, one of the main subjects was to find out conditions for and peculiarities of industrialization of the late-comers. Historical insight is needed to tackle these subjects. Rostow and Gerschenkron were the representative figures who gave a substantial influence on early development economics.

The concept of "take-off" occupied the central position in Rostow's stage theory of economic development (Rostow 1960). He asserted that transition from developing to developed countries could be recog-

2) "Structuralism" of development economics shares the dichotomous worldview that the economy of industrially developed countries and the economy of developing countries are different structurally.

nized whether the country concerned experienced the take-off or not, and he thought that after the take-off the country concerned would embark on a path of "self-sustaining growth". The unique characteristics of his hypothesis are as follows. First, he applied Keynesian type growth theory (Harrod-Domar growth model) to development economics and economic history. Secondly, he understood industrialization in a broader context of modernization, i.e., political, attitudinal, physiological, institutional changes of the people and society. Thirdly, he placed the increase of saving and investment at the center of the process of economic development. Also he stressed that a massive set of "pre-conditions" were necessary for the take-off and asserted that successful industrialization required more than the typical accoutrements associated with industrialization; notably, the increase of agricultural productivity and development of infrastructure was just as necessary.

Rostow's stage theory is a typical single-track development model. Gerschenkron criticized such kind of historical insight. Instead, he proposed an approach based on "how the processes and characters of industrialization change according to the degree of backwardness". He presented the following six propositions as the results of historical studies of industrialization of the 19th century European countries (Gerschenkron 1966).

(1) The more backward a country's economy, the more likely was its industrialization to start discontinuously as a sudden great spurt proceeding at a relatively high rate of growth in manufacturing output.

(2) The more backward a country's economy, the more pronounced was the stress in its industrialization on both manufacturing and

enterprise.

(3) The more backward a country's economy, the greater was the stress upon producers' goods as against consumers' goods.

(4) The more backward a country's economy, the heavier was the pressure upon the levels of consumption of the population.

(5) The more backward a country's economy, the greater was the part played by special institutional factors designed to increase supply of capital to the nascent industries and, in addition, to provide them with less decentralized and better informed entrepreneurial guidance. That is, the more backward the country, the more pronounced was the coerciveness and comprehensiveness of those factors.

(6) The more backward a country, the less likely was it's agriculture to play any active role by offering to the growing industries the advantages of an expanding industrial market based on in turn on the rising productivity of agricultural labor.

Gerschenkron's idea that "a great spurt" is necessary for industrialization is decisively different from Rostow's idea of "take-off". The difference lies in not only stage theory approach versus typological approach. Rostow stressed that for the take-off to be successful, "it must lead to progressively to sustained growth" and "further deep and often slow-moving changes in the economy and society as a whole" (Rostow 1984). This is exactly a Marshallian evolutionary development idea. On the contrary, Gerschenkron stressed the "jump" or "discontinuity" of the history. While Rostow asserted that various "preconditions" are necessary for industrialization of developing countries, Gerschenkron stressed the fundamental differences of "initial conditions" between advanced countries and backward countries. By stressing possibilities for catching-up by the backward countries, Gerschenkron's arguments opened a new domain for the issue of the late-industrialization (Amsden 1989; Wade 1990).

The most attractive proposition among Gerschenkron's hypothesis is that special institutional factors are formed according to the degree of backwardness. That is, in case of the most advanced country, namely England, the basic institutional element for industrialization was the factory system. However, in case of modestly backward countries such as Germany the long-term financial institutions, and in case of further backward countries such as Russia the state played the crucial role during the period of early industrialization each. These are the institutional innovations for backward countries to substitute for the missing prerequisites that the advanced countries had. Such kinds of new institutions that had appeared in backward European countries were devices to mitigate high risks facing with these countries and devices for catching-up to advanced countries[3].

In his presidential address at the American Economic Association of 1983, a great master of development economics, Sir Arthur Lewis, classified the subject of development economics into the areas of "the allocation of resources in the short run" and "matters relating to long-term growth". And again he classified the latter subject into the one of "the search for the engine of growth" and one of "the pattern of growth" (Lewis 1984). Among those subjects economic historians contributed a lot in the field of "the pattern of growth". Along with Rostow and Gerschenkron, the person who led this field was Simon

3) Nicholas Crafts highly values Gerschenkron's insights. He states that "the literature of asymmetric information and transaction costs can be used to capture and to sharpen Gerschenkron's insights on the boundaries of the firm, the role of the state, and the type of finance likely to be appropriate under conditions of backwardness" (Crafts 2001).

Kuznets. Having estimated long-term national incomes of developed countries, he extracted "universal factors" of the "modern economic growth". Analyzing population growth, trends of industrial structure, distribution of product and income, trends in the pattern of product use, trends in international interdependence, and so on, he founded the empirical studies of modern economic growth. According to Kuznets, the "epochal innovation" that distinguishes the modern economic epoch is the extended application of science to the problems of economic production (Kuznets 1966).

It was Hollis Chenery who succeeded the empirical works of Kuznets. He not only refined "the stylized facts" of the "modern economic growth" but also added theoretical explanations and policy implications of the stylized facts (Chenery 1988). He defined "the transformation of a traditional to a modern economic system" as "a set of interrelated changes in the structure of an economy that are required for its continued growth" (Chenery 1979). "A set of interrelated changes" involves transformations of demand, production, employment, external structure of trade and capital flows, urbanization, and other social changes. He used econometric methods to investigate such changes. He did not only time-series analysis, but also cross-section analysis. After describing the average patterns of development that was attained from the whole samples, he classified that average pattern into some subgroups according to the state of "different factor endowments" and "adoption of different development policies" that could not be measured by econometric method. He extracted three alternative types according to trade orientation and population size, namely "large country", "small primary export country", and "small manufacturing export country". And again he described the average development patterns of these three types. However, these types are also considerably modified by the government policies of each country. So he extracted four types of "development strategy" according to factor endowments (initial conditions) as well as policy choices, namely primary export specialization, import substitution, balanced development, and industry export specialization. It was Chenery's contribution to clarify that the universal law of structural changes should not be applied mechanically or strictly to every country, but rather there were many variations of the processes and timings of structural changes that vary according to the adopted development policies of each country.

2. The Epoch of Neo-Classical Approach to Development Economics: From Historical Studies to Policy Studies

The neo-classical approach has occupied the major position in development economics since 1970s. The neo-classical approach is the economics that stipulates that the price mechanism will adjust demand and supply and believes the market works in developing countries in the same manner as in developed countries. According to the neo-classical approach, there is no qualitative difference between economy of highly developed countries and that of developing countries, so that the same economics can be applied to both developed and developing countries. Hirschman called such an approach as the claim of "mono-economics".

It was Theodore Schultz who started the neo-classical resurgence in the field of development economics. He took up the case of India in 1918-19 where the influenza was rampant, and he criticized the notion of "disguised unemployment" that was the most important theoretical pillar of the structuralism of the development economics (Schultz

1969). Not only that. He demystified many propositions about traditional agriculture, for example, the myth that the traditional farmers were idle, the myth that the law of historically decreasing returns were applicable to traditional agriculture, and so on. Schultz urged that the insufficient agricultural investment in developing countries was caused not by the fact that farmers were idle but by the fact that profits were not guaranteed for farmers. He stressed that farmers' opportunity in developing countries was limited because of the traditional technology they used. Also he stressed that if there were enough human investment and technological innovations, even the farmers of developing countries behaved like *homo economics* and responded to the market just like the farmers of the developed countries. He argued that traditional farmers of the developing countries were "poor but efficient" and even the traditional agriculture of developing countries followed the economic law of rational allocation of scarce resources. This meant, according to Schultz, the "standard economic theory (i.e., micro-economics of neo-classical type)" can be applied to economic behavior of traditional farmers of developing countries too. His contribution gives us the insight that poverty is one thing and irrationality is quite another.

And neo-classical economists urged that it was not the slowing down of the world demand asserted by Prebisch and Singer but the mistaken trade policies of developing countries presupposing export pessimism, which was the most decisive factor to affect economic growth or export growth of developing countries. As a result, they rejected the validity of the inward-looking development policy being asserted by the structuralists, and conversely asserted that the outward-looking development policy was effective.

Also they presented the "government failure" hypothesis as an alternative view to the "market failure" hypothesis that was presupposed by the structuralists. They pointed out a variety of faults in structuralist ideas based on planning and inefficient public sector enterprises. In contrast they stressed the efficiency of the market mechanism and the necessity of making good use of private sector. The "competitive rent-seeking activity" by A. Krueger and "directly-unproductive profit-seeking (DUP) activities" by J. Bhagwati are the representative hypothesis by which neo-classical economists try to analyze government failures (Krueger 1974; Bhagwati 1982).

Based on such kinds of market liberalization arguments, the IMF and the World Bank built structural adjustment programs in 1980s. The twin oil crises of the 1970s and subsequent deflation of developed countries caused serious debt crisis in most of the non-oil developing countries. The IMF and the World Bank each approached to get the macro-economies of developing countries in order. They shared the same understanding that the characteristics of macro-economic disequilibrium and debt crisis were "structural" and the most crucial factor to overcome such disequiribrium was to have "a right economic policy". They demanded that the countries receiving structural adjustment loans pursue a series of policy reforms according to their "conditionality". The neo-classical approach of structural adjustment program, which is well known as the Washington consensus today, formed the contents of their conditionality.

In this period, the concept of long-run growth was replaced by the concept of structural adjustment and policy studies overtook historical studies. Development Economics without history predominated. Facing such a situation, Albert Hirschman declared the death of Development Economics and wrote an obituary of it (Hirschman 1981), and Arthur

Lewis lamented the appearance of the "widening gap between Economics and Economic History in Development Economics". He states that "If our subject (Development Economics) is lowering its sights, this may be because the demise of Economic History in economics departments has brought us a generation of economists with no historical background" (Lewis 1984).

3. "New Institutional Economics" and the Resurgence of History

A variety of criticism of the neo-classical approach emerged in 1990s. This resulted as the neo-classical approach that characterized the economic policy for structural adjustment by the IMF and the World Bank became increasingly stereotyped and rigid. There appeared a new consensus that the scope, the speed, and the sequence of economic reforms could be different for each developing country and people realized the crucial importance of the roles of internal politics as well as the state. Also people realized that historical, institutional, and cultural factors of each developing country were very important factors to decide the consequences of economic reforms. Arguments that shed light to the market failure revived and the New Institutional Economics (NIE), which attempts to understand the interface between three domains such as market, government, and institutions/organizations, emerged. World Development Reports by the World Bank were full of neo-classical flavor during the late 1980s, but the flavor has changed since 1990. *World Development Report 1997* that focused on the "state in a changing world" symbolized the emergence of the NIE in the world of development economics (World Bank 1997).

NIE accepts the basic microeconomic choice theory of optimum allocation of scarce resources based on utility hypothesis, but it modifies the premises of the general equilibrium theory that there is neither transaction cost nor information cost. If the market is not perfect because of transaction cost or information cost, then it will be a crucial issue to investigate resource allocation mechanism by non-market institutions/organizations. From this standpoint the economic behavior models that endogenize institutions/organizations are put forward. Asymmetric information economics advocated by the Ackelof-Stiglitz line and transaction cost economics advocated by the Coarse-Williamson lines are representative contributions. And Douglass North advocated the New Institutional Economic History that applied transaction economics to economic history. His ideas are summarized as follows (North 1990):

(1) In Neo-Classical Economics of Walrasian type, it is assumed that there is no transaction cost. However, there are transaction costs in real economic life, and a varieties of institutions have historically developed as devices to reduce transaction costs.

(2) In a society where personal exchanges are prevalent and people in the society have intimate knowledge of each other, there is a dense social network. The transaction costs are very small in such a society.

(3) As specialization and division of labor develops the exchange that depends on personal knowledge and continuous relationships vanish. Instead as exchange that depends on impersonal exchange develops uncertainty, risk and transaction costs increase. Therefore the chances to get profit by cheating, shirking, and free riding also increase.

(4) Institutions are necessary and have to be developed to reduce the transaction costs and to realize the benefits that can be attained by the development of specialization and the division of labor. In the Western society, such kinds of institutions took the form of establishment of various property rights, and only the government, that is the third party, could establish property rights and enforce the contracts. Ideology or an ethical code of behavior also played an important role.

(5) Transaction costs are sometimes enormous. When such costs reach a critical point, production and exchange can not occur. If in the factor markets and production markets the institutions that promote production and exchange are lacking, production and exchange can not be developed beyond the limit of personal relationship.

(6) The development of impersonal rule and contracts implies the emergence of the state and uneven distribution of cohesive power. It produces a chance for the individuals with superior cohesive power to make rules that are favorable to them without considering effects on efficiency. In other words, the rules are devised to benefit the politically dominant individuals, but those rules not necessarily reduce the transaction costs of the whole society. One of the lessons that can be learnt from the pre-modern world history is that the political system has an inherent tendency to produce inefficient property rights and finally to lead the stagnation or the decay of the state. There the state is just like organized crime. Even today the governments of the third world appear quite similar to a Mafia. In such societies, there is no enforcement mechanism of contracts by the third party, so that transactions are limited and

economic growth can not be promoted.

(7) Fundamental changes in relative prices are the most important source of institutional change. Changes in population, stock of knowledge, and technology (especially military technology) are the main factors that bring changes in relative prices.

The arguments by North, basically depending on the neo-classical microeconomics, developed the theory of the state. Also he shed light on the role of ideology and could overcome the contradiction of the free-rider argument. According to the Olsonian free-rider argument, this world is a jungle. If it is so, we can neither explain voluntary activities of the people nor the stability of society. By giving attention to the role of an ethical code of behavior, he presented a clue to the solution of the problem. North thought that the institutions change thorough the interactions between institutions and organizations. If the institutions are the "rules of the game", then organizations (or their leaders) are "players of the game". He explains that the most fundamental source of the institutional change from the long-term viewpoint is "learning through the history" by individuals and leaders of organizations, and this takes shape as "culture", namely a "cumulative learning of society" (North 1994).

Another notable discussion that declares the revival of history is the path-dependence theory presented by Paul David and Brian Arthur (David 1985; Arthur 1994). The essence of their discussions are summarized as follows:

(1) Modern complex technologies generate increasing returns with adoption. As adoption cumulates, the usage and experience that cumulate with it become incorporated into more reliable and effective variants.

(2) Once superior technology has appeared, there appears a tendency for that technology to "lock in".

(3) A host of small historical events outside our knowledge may decide the outcome.

(4) The reason why a specified technology supersedes another rival technology is that the buyer/user of that technology expects so. "Expectation" is a key element for a specified technology to lock in.

(5) In the case where increasing returns are predominant, leaisssez-faire does not guarantee that the superior technology can survive in the long run.

The issue that David and Arthur concentrated on was development history of technology[4]. But their arguments are so semantic that their hypothesis has been accepted in many other fields. The most interesting issue raised by them is that the superior technology does not necessarily dominate the market. According to the neo-classical economic theory, inferior technologies are driven out from the market because of competition and only the most superior technology can survive. However, if we look back on the history of technology, the inferior technology often survives and dominates the market. The same thing can be said in case of institutions (Bardhan 2001). In spite of inferior technologies or inferior institutions, often it is very difficult to replace them in real economic life, so that the economy can not develop. Everybody knows that the driving forces of economic development are innovations of technologies and institutions. In spite of knowing that, if we can not put

4) Other notable discussions are "evolutionary theory" advocated by Nelson and Winter (Nelson & Winter 1987) and Comparative Institutional Analysis advocated by Aoki (Aoki 1995).

them into practice, the reason should be found in the fact that the people and country are not free from their history. The policy advice that lacks insights on history is nothing more than an armchair theory.

4. Development Economics in Future Perspective

What kind of characteristics can we find out in the resurgence of history by the New Institutional Economists? According to Landes, these histories are not written by "economic historians", but "historical economists" (Landes 2001). As naming by Landes suggests, the gap between history and theory is not narrow at all. The history of rising markets written by Hicks, just as the economic interpretation of history written by Karl Marx, tried to build a theory of history. Neither history without theory nor theory without history is so attractive for development economists, but the gap between economic historians and historical economists is not narrow. It is an urgent task to bridge this gap and bridging the gap should lead to historical studies that reexamine the validity of neo-classical economics. New Institutional Economics is one of the candidates to do so. Avner Greif, along with Douglass North, who advocates the resurgence of historical studies, stresses the necessity of the reorientation of research agenda from growth accounting approach to the understanding of the process of development "on the basis of micro level, context-specific institutional analysis" (Greif 2001).

Lastly, we should refer to an essential area of thought on development that should be remembered. That is the capability approach by Amartya Sen which along with NIE predominates in the development world of today (Sen 1999). Both approaches, capability approach and

NIE, are quite different both their standpoints and analytical frameworks. But each approach has emerged from the systematic criticism of the neo-classical economics. So far as each approach stresses the necessity of establishing a new microeconomics, they share a common spirit though it is very thin. The reason why Sen's capability approach appeals to us so deeply lies in the fact that he starts his argument not from the state but from the individual person and from there he follows a quest for the meaning of development. For the individual person "development" means a set of wishes to "live a decent life". Because such wishes are penetrating among the people, development policy at the state level can be justified. Today Sen's argument has a tremendous influence not only on UNDP but also on the development thought of the World Bank (World Bank 2001). This is a development idea that investigates the quality of life of the people and the quest for the identity of development studies.

It is an urgent task to promote research on human behaviors and human motivations that goes beyond the limit of the utilitarian approach of neo-classical economics in the context of development studies. In other words, a viewpoint that overcomes a rational behavior model in a narrow sense is required. This is exactly the domain where the historical studies are essential.

Even today if the notion that "all history is the contemporary history" is the truth, historical studies will revive as a leading thread for development economics.

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