



**Department of Distance Education  
Punjabi University, Patiala**

(All Copyrights are Reserved)

**M.A. (ECONOMICS) PART-I  
SEMESTER-I**

**PAPER : ECO-104**

**ECONOMICS OF GROWTH AND DEVELOPMENT**

**SECTION- A**

**BOTH MEDIUM**

**SECTION- A**

**LESSON NO :**

- 1.1 : Development: Concept Measurement and Problem.
- 1.2 : Economics Development and Structural Change
- 1.5 : Theory of Institutional Change: Schumpeter and North.
- 1.6 : Dependency Theory of Development-II Paul Baran's Andre Gunder Frank
- 1.7 : Dependency Thoery of Development-II Samir Amin

**DEVELOPMENT: CONCEPT, MEASUREMENT AND PROBLEMS**

**Lesson Plan**

- 1.1.1 Introduction
- 1.1.2 Objective of the lesson
- 1.1.3 Development: Meaning
  - 1.1.3.1 Core Values of Development
- 1.1.4 Economic Development and Economic Growth
- 1.1.5 Measures of Development
  - 1.1.5.1 Gross National Product/Per Capita GNP measure
  - 1.1.5.2 Purchasing Power Parity (PPP) method
  - 1.1.5.3 Physical Quality of Life Index (PQLI)
  - 1.1.5.4 Human Development Index
- 1.1.6 Problems of International Comparisons
- 1.1.7 Summing Up
- 1.1.8 Questions for Practice: Long Answer Type
- 1.1.9 Questions for Practice: Short Answer Type
- 1.1.10 Suggested Readings

---

**1.1.1 Introduction**

Traditional economics is primarily concerned with efficient and least-cost allocation of scarce productive resources, and the growth of these resources over time. Political economy, on the other hand, is concerned

with the social and institutional processes through which certain groups of economic and political elites influence the allocation of these scarce productive resources. However, development economics is an extension of both traditional economics and political economy, in that it also deals with the economic, social, political and institutional mechanisms necessary to bring about rapid and large scale improvements in the levels of living of poor people in developing nations.

In studying development economics, thus, the first issue/question that we face is regarding the meaning of the term 'development'. Equally important is to distinguish between 'development' and 'growth'. The measures of development in terms of various indicators are also of crucial importance. All these aspects will be taken up in the present lesson.

### **1.1.2 Objective of the lesson**

The objective of the present lesson is to help the students understand the meaning of the term 'development'. It will also enable them to distinguish between the terms 'development' and 'growth', as very often, one tends to use these terms interchangeably. The measurement criteria of the term 'development' will also be discussed in this lesson, because without such a criteria, it will not be possible to determine which country was actually developing, and which was not.

### **1.1.3 Development: Meaning**

In strictly economic terms, development (or economic development) refers to an increase in the economy's real national income over a long period of time. In other words, it is the capacity of a national economy, whose

initial economic condition has been more or less static for a long time, to generate and sustain an annual increase in its gross national product (GNP) at rates of 5% to 7% or more (Todaro, p. 15). A short period rise in national income which occurs during the upswing of a business cycle does not constitute economic development.

However, this definition fails to take into consideration changes in growth of population. Thus, an alternate economic index of development has been the use of rate of growth of per capita GNP to take into account the ability of a nation to expand its output at a rate faster than the growth rate of its population. Again, an increase in per capita income may not raise the real standard of living of the masses. The masses can remain poor despite an increase in the per capita income, if the increased income goes to a few rich instead of going to the many poor.

Thus, before 1970s, development was taken to mean an economic phenomenon in which rapid gains in overall and per capita GNP growth would trickle down to the masses in the form of jobs and other economic opportunities, and create conditions so that the economic and social benefits of growth are widely distributed. But problems like poverty and unemployment were considered secondary in these definitions. Post-1970, economic development was redefined in terms of reduction of poverty, inequality, and unemployment. This was because during the 1960s, and 1970s, a large number of developing countries experienced high rates of growth of per capita income, but little or no improvement, or even a decline, in employment, equality, and real incomes of the bottom 40% of their populations. Development, thus, was conceived of as a

multidimensional process, representing the whole gamut of change in which the social system moves away from an unsatisfactory condition of life to a materially and spiritually better life.

In this context, Amartya Sen – a Noble Prize winner in Economics – has identified the human goals of economic development. His views are termed as the *Capabilities Approach*. Sen has argued that what matters are not the things that a person has, but what a person, is or can be, and does, or can do. In other words, it means that to understand the concept of human well being and poverty, it is more important to consider the use of commodities, not just their availability. Sen then proceeds to define capabilities as "the freedom that a person has in terms of the choice of functioning, given his personal features and his command over commodities."

Sen's perspective helps us to understand why development economists place emphasis on health and education, and why countries with high levels of income but poor health and education standards are referred to as 'growth without development'.

In order to define or conceptualize development as the sustained elevation of the society towards a better or more humane life, three basic components or core values – representing common goals sought by all societies/individuals – have been identified. These are discussed as under:

**1.3.1 Core Values of Development:** The core values of development relate to fundamental human needs.

- (a) Sustenance** – The ability to meet basic needs: Food, shelter, health, and protection are the basic life sustaining human needs. Absence of any of these is a condition of absolute underdevelopment. Thus, a basic function of economic activity is to provide as many people as possible the means of overcoming the helplessness and misery arising from a lack of food, shelter, health and protection. Economic development is a necessary condition for the improvement in the quality of life. Without sustained and continuous economic progress, both at the individual and societal level, realization of human potential is not possible. Rising per capita incomes, elimination of poverty, more employment opportunities thus constitute the necessary but not sufficient conditions for development.
- (b) Self-Esteem:** A sense of worth and self respect, and not being used as a tool by others for their own ends, is the second universal component of good life. The nature and form of this self-esteem may vary from society to society. Prosperity has become the universal yardstick of worth, and worthiness and esteem are increasingly conferred only on countries that possess economic wealth and technological power, i.e. those that have 'developed'.
- (c) Freedom from Servitude:** The meaning of development should also constitute the concept of human freedom. Freedom here means the emancipation from national conditions which are alienating, and from social servitude to nature, ignorance, misery, and dogmatic beliefs. Freedom involves and expanded

range of choices for humans along with a minimization of external constraints in the pursuit of some social goal we call development. Lewis had stressed the relationship between economic growth and freedom from servitude. Wealth can enable people to gain greater control over nature and physical environment. They also have the freedom to have greater leisure.

To conclude, development is not only a physical reality, but also a state of mind. Development, thus, must have three objectives:

- (i) To increase the availability and widen the distribution of basic life-sustaining goods such as food, shelter, health, and protection;
- (ii) To raise the levels of living, including, in addition to higher incomes, the provision of more jobs, better education, greater attention to cultural and human values. These will not only enhance material well-being but also generate self-esteem.
- (iii) To expand the range of economic and social choices available to individuals and nations by freeing them from servitude and dependence in relation to other people as well as to the forces of ignorance and human misery.

Having understood the meaning of economic development, let us now turn to make a distinction between economic development and economic growth.

### **1.1.4 Economic development and economic growth**

The term economic development is very often used inter-changeably with economic growth. The difference between the two is explained by Kindleberger as: Economic growth means more output, while economic development implies both more output and changes in the technical and institutional arrangements by which it is produced and distributed. Growth may involve more output and greater efficiency (i.e. increase in output per unit of input) but development goes beyond this, to apply changes in the composition of output and in allocation of inputs by all sectors of the economy.

Friedman defines growth as an expansion of the system in one or more dimensions without a change in its structure, while development is an innovative process leading to the structural transformation of social system.

While drawing a distinction between development and growth, it is important to distinguish a number of different sources of contrast from each other. The first is that while economic growth is concerned only with GNP per head, but not its distribution among the population. It is possible for a country to have an expansion of GNP per head while its distribution becomes more unequal. Development, on the other hand, is concerned with the distributional aspect.

Another source of the difference between growth and development relates to the question of externality and non-marketability. GNP captures only those means of well-being that happen to be transacted in the market. Even if non-marketed goods are included, the evolution is usually only for

those goods for which market prices can be traced. It is the task of development to recognize the contribution of (non-marketable) environment and natural resources to our well being. Third, even when markets exist the valuation of commodities in the GNP will reflect the market biases. Relative prices are different in different parts of the world. Even for a given economy, the relative importance attached to one commodity compared with another may be distorted vis-a-vis what might be achieved under perfectly competitive conditions if the market operations happen to be institutionally imperfect. Fourth, the real income enjoyed by a person in a given year will only reflect the extent of well being enjoyed by him at that period time (this relates to 'growth'). But in assessing what kind of a life the person is living, a more integral view of the person's life has to be taken into account – the length of that life, for example (this relates to development).

Also, it is important to note that GNP is only a measure of the amount of the means of well being that people have, but it does not tell us what the people involved are succeeding in getting out of these means, given their ends. Thus, the concept of development has to take note of the actual achievements, and not just the quantification of the means of that achievement. Development has to go beyond GNP information ('growth'). The information provided by GNP is fundamentally inadequate for the concept of development.

### **1.1.5 Measures of Development**

Having understood the meaning of development, and its difference from growth, our next concern should be the measurement of development.

Here we will study the traditional economic measures, as well as the relatively new methods of measurement of development. While the gross national product (GNP) and per capita income (GNP), as well as the purchasing power parity (PPP) are classified as the traditional measures, the human development index (HDI) and the physical quality of life index (PQLI) are the more recent measures of development. Let us study these.

### **1.5.1 Gross National Product (GNP)/Per Capita GNP measure**

Development has traditionally been measured (as already mentioned earlier in this lesson), as the capacity of national economy, whose initial economic condition has been more or less static for a long time, to generate and sustain an annual increase in its GNP at rates of perhaps 5 per cent to 7 per cent or more. Another measure used has been the GDP, or the gross domestic product.

An alternative economic index of development is to measure it by the rate of growth of income per capita (PCI) or per capita GNP, which depicts a nation's ability to expand its output at a rate faster than the growth rate of its population. The levels and rates of growth of real per capita GNP (monetary growth of GNP per capita minus the rate of inflation) are used to measure the overall economic well being of the population.

However, there are some difficulties in using this measure. Measuring development by GNP fails to take into consideration changes in the growth of population. A rise in national income accompanied by a faster growth in population does not amount to development. Similarly, an increase in per capita income may not raise the real standard of living of the masses. An increase in per capita income does not necessarily mean

an increase in per capita consumption. The masses can remain poor despite an increase in per capita income if this increase is going to a few rich only. Moreover, such a definition subordinates the issue of structure of the society – the size and composition of its population, its institutions and culture, the resource patterns and an even distribution of output.

#### **1.1.5.2 Purchasing Power Parity (PPP) method**

When comparisons have to be made between developed and less developed nations to gauge their level of development, per capita GNP comparisons are often exaggerated by the use of official foreign exchange rates to convert the less developed country's (LDC) national currency figures into U.S. dollars. The relative domestic purchasing power of different currencies is not measured by this conversion. To solve this problem, GNPs (and GDPs) are compared by making use of purchasing power parities (PPPs). PPP is defined as the number of units of a foreign country's currency required to purchase the identical quantity of goods and services in the local market of the less developed country as \$1 would buy in the United States. PPPs thus use a common set of international prices for all goods and services produced, by valuing goods in all countries at U.S. prices.

Thus, if LDC domestic prices are lower, PPP measures of GNP per capita will be higher than estimates using foreign exchange rates as the conversion factor. Income gaps between rich and poor nations tend to be less when PPPs are used.

#### **1.1.5.3 Physical Quality of Life Index (PQLI)**

Deterioration in the economic conditions of the bulk of population in less developed countries despite some growth, led to the formulation of a non-income index of development. Morris D. Morris constructed a composite PQLI in 1976 relating to 23 developing countries for a comparative study. The objective was to develop an index which would relate to the conditions of the vast majority of the population of a country. Morris selected three variables viz. literacy rate (x), infant mortality rate (y) and life expectancy at birth (z) and built up a PQLI. For combining the variables, Morris used a scaling procedure with the lowest value put at 1 and the highest value put at 100. He then took a simple average of the three transformed variables to arrive at PQLI.

The advantages of using PQLI over the previous methods discussed are:

- (i) the index is free from market value considerations because no element is expressed in national currency;
- (ii) the index is neutral in respect of political and allied structural organization of a country, which facilitates inter-country comparisons;
- (iii) the index is not affected by cultural diversities;
- (iv) it is a simple method, easily understood by even laymen.

However, there are some difficulties/limitations also for using PQLI, which are noted as under:

- (i) upward movement of the index measures improvement in PQLI, but does not give any clue of how improvement in the physical quality of life has been achieved.

- (ii) Morris did not give any reason for giving equal weights to the three component indices.
- (iii) The index is affected by the quality of data available for countries.
- (iv) The index ignores, i.e. does not measure, various social and psychological aspects of the quality of life.

Mukherjee, Ray and Rajyalakshmi repeated Morris's calculations at the international level, introducing certain minor refinements in the process. Unlike Morris, they used the range 0-100 instead of 1-100. They also scaled the percentage literacy consistently. Their scaling procedure for literacy is given by the formula

$$X_i = \frac{x_i - x_0}{x_m - x_0} \times 100$$

where  $X_i$  is the scale value for the  $i^{\text{th}}$  country,  $x_i$  its literacy rate,  $x_0$  is the lowest literacy rate and  $x_m$  is the highest literacy rate. The formula for  $z$  will also be similar. The scale value for infant mortality ( $y$ ) is given by:

$$y_i = \frac{y_i - y_m}{y_0 - y_m} \times 100$$

because physical quality of life improves when infant mortality reduces.

Despite its limitations, the PQLI can be used to identify particular regions of underdevelopment and groups of societies suffering from the neglect of failure of social policy.

#### **1.1.5.4 Human Development Index (HDI)**

The HDI is used for measuring quality of life in countries across the world. The HDI ranks all countries on a scale of 0 (zero – lowest human development) to 1 (highest human development) based on three goals or end products of development:

- (i) longevity, as measured by life expectancy at birth;
- (ii) knowledge, as measured by a weighted average of adult literacy (two-thirds) and mean years of schooling (one-third);
- (iii) standard of living as measured by real per capita income adjusted for the differing purchasing power parity of each country's currency to reflect cost of living and for the assumption of diminishing marginal utility of income.

Using the above three measures of development and applying a formula to data for 175 countries, HDI then ranks all countries into three groups: low human development (0.0 to 0.499); medium human development (0.50 to 0.799); and high human development (0.80 to 1.0).

Over the years, calculation of HDI has been simplified. Adjusted income is now simply found by taking the natural log of current income. Income index is then found by subtracting the natural log of 100 from the natural log of current income (because the lowest that per capita income could possibly be in any country is \$100PPP. The difference gives the amount by which the country has exceeded this 'lower goalpost'. The UNDP then takes \$40,000 PPP as the maximum that a country could reasonably aspire to have over the coming generation. Then we divide by the difference between the log of \$40,000 and the log of \$100 to find the

country's relative income achievement. This gives each country an index number that ranges between 0 and 1.

$$\therefore \text{Income index} = \frac{\log(\text{current income}) - \log(100)}{\log(40,000) - \log(100)}$$

To find the life expectancy index (which serves as a proxy for health), the UNDP takes a country's current life expectancy at birth, then subtracts 25 years (which serves as the lower goalpost i.e. the lowest life expectancy that could have been in any country over the last generation). The result is divided by 85 years minus 25 years, i.e. 60 years, which represents the expected range of life expectancies.

$$\therefore \text{Life expectancy index} = \frac{\text{current life expectancy at birth} - 25}{85 - 25}$$

The education index is made up of two parts: two-thirds weight is assigned to literacy and one-third weight on school enrolment. Gross school enrolment can exceed 100% because older students might go back to school, thus this index is capped at 100%.

$$\text{Adult literacy index} = \frac{\text{Percentage of Adult literacy} - 0}{100 - 0}$$

Gross enrolment index

$$= \frac{\text{Percentage of primary, secondary and tertiary age population enrolled in school} - 0}{100 - 0}$$

$$\therefore \text{Overall education index} = \frac{2}{3}(\text{adult literacy index}) + \frac{1}{3}(\text{gross enrolment index})$$

Thus,

$$\text{HDI} = \frac{1}{3}(\text{income index}) + \frac{1}{3}(\text{life expectancy index}) + \frac{1}{3}(\text{education index})$$

HDI clearly points out that by development is meant broad human development, not just higher income. The index is better than other measures in the sense that it not only includes income (which is the single most important factor in determining the well being of the poor in less developed countries), but also takes account of the social progress as indicated by an improvement in educational attainment and life expectancy. The HDI thus stresses the importance of the quality of life.

Some drawbacks in HDI cannot be ruled out. One is that gross enrolment in many cases overstates the amount of schooling because very often the dropouts are not taken care of. Then, because the variables are measured in different types of units, it is difficult to say exactly what equal weights mean. And finally, HDI ignores the role of quality. For example, there is a difference between an extra year of healthy life and an extra year of life confined to bed. Also, there could be better proxies for health and education but data for these might not be available for all countries.

However, the fact remains that when HDI is used in conjunction with traditional economic measures of development, it greatly increases our understanding of development levels in countries.

We have studied above some measures of development. Each measure has its own advantages and drawbacks. The real problem arises when we have to make international comparison using various development indicators. Some of these problems of international comparisons are discussed below.

### **1.1.6 Problems of international comparisons**

When we measure development using GNP or per capita national income, we know that a variety of measurement problems arise. In the making of international comparisons, these problems multiply. When the monetary authority of a country does not permit free convertibility of its domestic currency into foreign exchange then it is hard to choose an exchange rate that appropriately expresses a country's output in terms of, say dollars. Most poor countries have overvalued exchange rates. In this case if their national income data, stated in units of their local currency, is converted into dollars using official exchange rates as the conversion factor, the dollar amounts will be overstated. The official, over valued exchange rate thus overstates per capita incomes.

Even where currency exchanges are unrestricted, conversion of income data between currencies is biased because the internationally traded goods and services may not be representative of the price and value relationships among the country's total goods and services.

Thus, the net effect of biases on international comparisons can be summarized as: the degree of understatement is greatest for the poorest countries and decreases as income levels rise. The money measures of income exaggerate and distort the differences among countries. However, they are useful in providing a fairly accurate picture of the ranking, if not the absolute level, of countries with respect to real consumption (Herrick and Kindleberger).

Social indicators, on the other hand, are direct and partial measures of well being in a society. They are direct measurements in that

they make use of data that can be collected and interpreted without recourse to complex imputation. Social indicators are partial in that they cannot be readily aggregated and each one gives an incomplete indication of the level of welfare.

It has been pointed out by Herrick and Kindleberger that the direct nature of the social indicators – their direct reflection of some of the most basic facets of human life and human concerns – gives them considerable appeal over the conventional measures (of per capita income) for international comparisons. However, these cannot displace the more conventional measures of economic advance.

### **1.1.7 Summing Up**

In this lesson, we have studied about the concept of development, its difference with growth, and the various measures or indicators of development. Each measure has its own advantages and drawbacks. There are problems in making international comparisons when different indicators are used, but it is being pointed out that measures such as HDI pose less problems of comparisons than the conventional measures of GNP or per capita income. However, no method can completely displace the other.

### **1.1.8 Questions for Practice**

#### **Long Answer Type**

- (i) What do you understand by the term Development? What are the core values of development? Critically examine the traditional methods of measuring development.

- (ii) Distinguish between development and growth. Discuss the PQLI as a measure of development.
- (iii) Define Development. Examine the HDI as a method of measuring development.
- (iv) How is PQLI different from HDI as a measure of development? Discuss in detail.

### **1.1.9 Questions for Practice**

#### **Short Answer Type**

- (i) Distinguish between development and growth.
- (ii) Define Purchasing Power Parity.
- (iii) Which are the three goals/end products of development taken in HDI?
- (iv) Give the advantages of using PQLI as a measure of development.
- (v) Briefly give the core values of development.

#### **1.1.10 Suggested Readings**

1. Michael P. Todaro and Stephen C. Smith: Economic Development.
2. H. Chenery and T.N. Srinivasan (ed.): Handbook of Development Economics Vol. I (Chapter I – The Concept of Development by Amartya Sen).
3. M. Mukherjee, A.K. Ray and C. Rajyalakshmi: "Physical Quality of Life Index: Some International and Indian Applications", Social Indicators Research 6 (1969), pp. 283-292.
4. Herrick and Kindleberger: Economic Development.

## **ECONOMIC DEVELOPMENT AND STRUCTURAL CHANGE**

- 1. Introduction**
- 2. Objectives of the Lesson**
- 3. Kuznets's Inverted U- Hypothesis**
- 4. Chenery's Patterns of Structural Change**
- 5. Conclusion**
- 6. Technical terms**
- 7. Short answer type questions**
- 8. Long answer type questions**
- 9. Recommended Books**

### **1. Introduction**

The **patterns-of-development analysis** of structural change focuses on the sequential process through which the economic, industrial, and institutional structure of an underdeveloped economy is transformed over time to permit new industries to replace traditional agriculture as the engine of economic growth. However, in contrast to the Lewis model and the original stages view of development, increased savings and investment are perceived by patterns-of-development analysts as necessary but not sufficient conditions for economic growth. In addition to the accumulation of capital, both physical and human, a set of interrelated changes in the economic structure of a country are required for the transition from a traditional economic system to a modern one. These structural changes involve virtually all economic functions, including the transformation of production and changes in the composition of consumer demand, international trade, and resource use as well as changes in socioeconomic factors such as urbanization and the growth and distribution of a country's population.

## 2. Objectives of the Lesson

In this lesson we will study about the following theories of economic development and structural change:

1. Kuznets's Inverted U- Hypothesis
2. Chenery's Patterns of Structural Change

## 3. Kuznets's Inverted U- Hypothesis

There has been much controversy among economists over the issue whether economic growth increases or decreases income distribution. Prof. Kuznets is the first economist to study this problem empirically. He observes that in the early stages of economic growth relative income inequality increases, stabilizes for a time and then declines in the later stages. This is known as the *inverted U-shaped hypothesis* of income distribution.

In his 1955 Study, Kuznets takes the following data relating to three LDCs—India, Ceylon and Puerto-Rico and two DCs—U.K. and U.S.

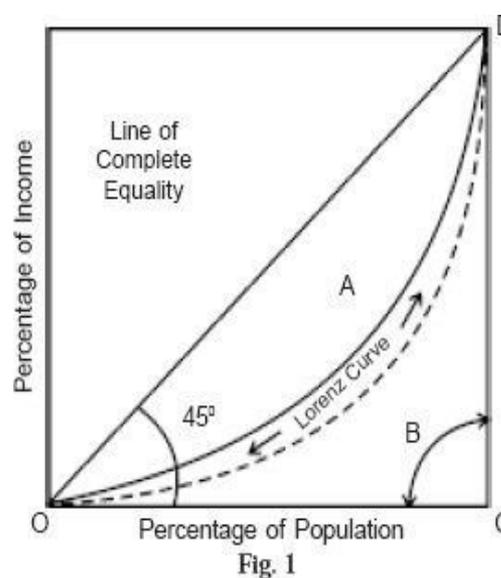
Table 1 shows that in LDCs 60% of the poorest received 30% and less of national income, whereas in DCs they received more than 30% of national income. So far as the richest 20% in LDCs are concerned, they received 50% and more of national income. In DCs, they received 45% and less. Kuznets comes to the conclusion that the size distribution of income was more unequal in LDCs than in DCs. It was high (1.67 to 2.33) in LDCs and low (1.25 to 1.29) in DCs.

**Table 1: Relative Income Inequality in Various Countries in about 1950**

| Country               | Income Share%  |                | Ratio = $\frac{\text{Richest 20\%}}{\text{Poorest 60\%}}$ |      |
|-----------------------|----------------|----------------|---|------|
|                       | Poorest<br>60% | Richest<br>20% |   |      |
| India (1949-50)       | 28             | 55             | 1.96  | LDCs |
| Ceylon (1950)         | 30             | 50             | 1.67  |      |
| Puerto-Rico (1948)    | 24             | 56             | 2.33  |      |
| United Kingdom (1950) | 34             | 44             | 1.29  | DCs  |
| United States (1947)  | 36             | 45             | 1.25  |      |

It was in his 1963 study that Kuznets developed his inverted U-shaped hypothesis by taking the data of 18 countries by size distribution of income. On their basis, he constructed different Lorenz curves for DCs and LDCs and derived their Gini coefficients. It was 0.37 for DCs and 0.44 for LDCs. It showed that income inequalities were higher in LDCs than in DCs and .This is explained in Figure 1 where the 45° straight line  $OD$  is of equal income distribution. The thick curve to the right and nearer to this line is the Lorenz curve of DCs. The dotted curve further to the right represents the Lorenz curve of LDCs.

But the Gini coefficient of distribution is a better measure of the degree of income inequality. It varies from 0 (complete equality) to 1 (complete inequality). The larger the coefficient, the greater the inequality. The Gini coefficient is measured in Figure 1 as the ratio of area  $A/A + B$  or  $A/\Delta OCD$ . The greater is this ratio, the more unequal is the distribution of income i.e., the more the Lorenz curve falls below the 45° line. In Figure 1, the area  $A$  covered by the thick Lorenz curve roughly represents 37% of the triangle  $OCD$  for DCs and the area covered by the dotted Lorenz curve represents roughly 44% of the area of the triangle  $OCD$  for LDCs.



The changes in the distribution of income as measured by the Gini coefficient in relation to the increase in per capita income trace out the Kuznets inverted U-shaped curve  $K$ , as shown in Figure 2. “Note that the more robust portion of the Kuznets curve lies to the right: income inequality falls with an increase in per capita income at higher levels of development. The variance around the estimated Kuznets curve is greatest, however, from low to middle levels of development.”

The inverted U-shaped curve hypothesis applies to the present developed and developing countries but the degree of inequality in the latter is greater than in the former.

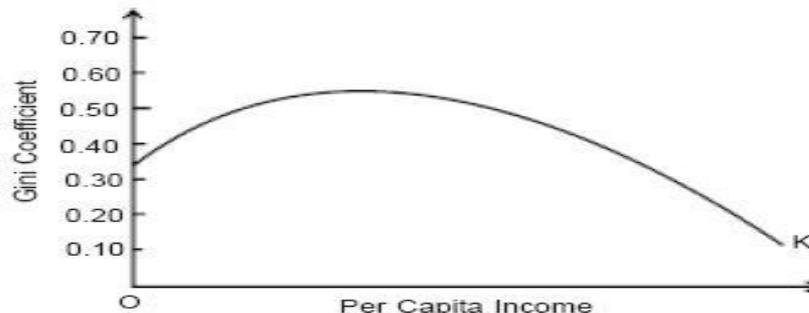


Fig. 2

### Self-Check Exercise 1

**Q. What does a Gini coefficient value 1 indicates?**

---



---

### Causes of Increase in Inequality with Development

There are many factors which tend to increase relative income inequality in the early stages of development in LDCs.

- LDCs are characterized by geographic, social, financial and technological dualism. When the process of transition from a traditional agricultural society to modern industrial economy begins, it increases inequalities in income distribution. There are structural changes which lead to increasing employment opportunities, exploitation of new resources, and improvements in technology. All these lead to increase in per capita income in the industrial sector. The incomes of workers, managers, entrepreneurs, etc. in urban areas increase more rapidly. But income per capita of workers engaged in agricultural and non-agricultural occupations in rural areas does not rise due to subsistence agriculture, defective land tenure system and rural backwardness.
- The industrial sector uses capital-intensive techniques which absorbs only educated, skilled and trained workers. Workers in this sector have high incomes and employers earn large profits.

Thus, the modern industrial sector grows faster than the rural subsistence sector. As a result, the relative share of income and profit in national income of this sector rises, more than in the rural sector.

- The migration of rural population to urban areas does not provide gainful employment opportunities to the uneducated and unskilled people in towns and cities. The majority of them become vendors of fruits, vegetables, newspapers, etc., car washers, waiters, porters, shop assistants, domestic servants, etc. All such persons are underemployed and have low incomes.
- When migration to urban areas starts in the early stages of development, some landlords also move to the urban sectors who invest in urban property, stocks, bonds, etc. Such investments bring them higher incomes than from land ownership in rural areas.
- On the other hand, with technological advance and increase in financial facilities in urban areas, a new class of entrepreneurs emerges which leads to diversification in manufacturing, trade and business. Consequently, incomes and profits of persons engaged in them increase.
- There is urban bias in the allocation of financial resources for development on the part of governments with the result that the rural economy remains backward with disguised unemployment and low per capita income.
- Governments in LDCs find it difficult to pass and implement legislation relating to land reforms and other economic measures due to concentration of income and wealth among the rich due to political reasons. Consequently, income inequalities increase.
- Further, such governments are financially weak and are not in a position to spend on such social security measures as free education, health facilities, etc. which reduce poverty and increase per capita income. They also do not impose heavy taxes on incomes and profits so as to increase saving, investment and capital formation.
- Above all, higher growth rate of population among the masses in LDCs increases the absolute number of people and hence relative inequality.

**Causes of Reduction in Inequality with Development**

- Kuznets gives two reasons for the decrease in inequality of income distribution when the country reaches high income levels in the later stages of development. *First*, the per capita income of the highest income groups falls because their share of income from property decreases. *Second*, the per capita income of the lowest income groups rises when the government takes legislative decisions with respect to education and health services, inheritance and income taxation, social security, full employment and economic relief either to whole groups or individuals.
- As development proceeds, it sets in motion a chain of cumulative expansion in the industrial sector, thereby leading to higher per capita income. This, in turn, increases the demand for farm products and other products of rural and backward areas which raise the per capita income of the people of these areas. This is what Hirschman calls “*trickling down effects*” and Myrdal calls “*spread effects*” of development.
- Besides, the incomes of rural areas also increase from urban remittances and / or foreign remittances. People belonging to rural areas but working in urban areas and/or living in foreign countries remit large sums to their dependents.
- Above all, as development gains momentum the growth rate of population declines which increases per capita income.
- As pointed out by Montek S. Ahluwalia, the improvement in income distribution observed in the later stages of development has been due to intersectoral shifts in the structure of production, expansion in educational attainment and skill of the labour force, and reduction in the rate of growth of population.

**Self-Check Exercise 2**

**Q. Describe any two causes of increase in inequality with development?**

---

---

---

### **Critical Appraisal**

Kuznets' inverted U-hypothesis has been empirically tested and confirmed by some economists while others find it the other way. Kravis in his study of eleven developing and developed countries confirms the Kuznets hypothesis that the degree of inequality first increases at lower levels of development and then declines at higher levels of development. Adelman and Morris in their study of 43 developing and 13 developed countries work out the average Gini coefficient as 0.47 and 0.29 respectively. They come to the conclusion that income inequality increases up to a certain level of development and then declines, thereby confirming the Kuznets inverted U-hypothesis. Similarly, Montek S. Ahluwalia in his analysis of the data for 60 countries finds that relative income inequality increases substantially in the early stages of development with reversal of this tendency in the later stages.

Despite these, the validity of the Kuznets inverted U-hypothesis has been questioned on the basis of the data taken by Kuznets and others for their studies. Kuznets takes a very small sample of developing and developed countries. Critics opine that his analysis is based on 5 per cent empirical information and 95 per cent speculation.

According to Todaro, the long-run data for developed countries do seem to support the Kuznets hypothesis but the studies of the phenomenon in LDCs have produced conflicting results. His study of 13 LDCs shows that higher income levels can be accompanied by falling and not rising inequality." Todaro also finds fault with the methodology used by economists to test the Kuznets hypothesis. The time-series data being not available for most LDCs, economists use cross-sectional data. Using cross-sectional data for a time-series phenomenon for drawing conclusion is basically wrong. In a recent study, Anand and Kanbur have shown that the choice of data as the measure of inequality may lead to U-relationship between income inequality and development, inverted-U relationship or no relationship at all.

### **4. Chenery's Patterns of Structural Change**

The Chenery model of structural change is based largely on the empirical work of Harvard economist Hollis B. Chenery and his

colleagues, who examined patterns of development for numerous developing countries during the post-war period. Their empirical studies, both cross-sectional (among countries at a given point of time), and the time-series (over long periods of time), of countries at different levels of per capita income led to the identification of several characteristic features of the development process. These include the shift from agricultural to industrial production, the steady accumulation of physical and human capital, the change in consumer demands from emphasis on food and basic necessities to desires for diverse manufactured goods and services, the growth of cities and urban industries as people migrate from farms and small towns, and the decline in family size and overall population growth as children lose their economic value and parents substitute what is traditionally labeled child quality (education) for quantity with population growth first increasing and then decreasing in the process of development.

Chenery defines the development pattern “as a systematic variation in any significant aspect of the economic or social structure associated with a rising level of income.” But he is primarily interested in those structural changes that are needed to achieve sustained increase in per capita income.

In describing the process of development, he replaces the notion of a dichotomy between less developed and developed countries with the concept of “transition” from one stage to another. He defines transition “as a set of structural changes that have almost always accompanied the growth of per capita income in recent decades.”

### **Development Processes**

Chenery takes *three* principal developments which are further divided into *ten* basic development processes that describe different dimensions of the overall structural transformation of a less developed country to a developed one. They are as follows:

#### **i. Accumulation Processes**

1. Investment
2. Government revenue
3. Education

**ii. Resource Allocation Processes**

1. Structure of domestic demand
2. Structure of production
3. Structure of trade

**iii. Demographic and Distributional Processes**

1. Labour allocation
2. Urbanization
3. Demographic transition
4. Income distribution

These characteristics of the development process are explained as under:

**i. Accumulation Processes**

Accumulation is the use of resources to increase the productive capacity of an economy. The accumulation processes comprise:

1. *Investment* consisting of (a) gross domestic savings as % of GDP, (b) gross domestic investment as % of GDP, and (c) capital inflow (net imports of goods and services) as % of GDP.
2. *Government revenues* consisting of (a) government revenues as % of GDP, and (b) tax revenues as % of GDP.
3. *Education* consisting of (a) education expenditure by government as % of GDP, and (b) enrollment ratio.

Changes in these accumulation processes take place relatively early in the transition.

There is substantial variation in accumulation process in the inflow of capital at low income levels.

Unlike saving and investment, the rise in taxation and government revenue and expenditure is a relatively late process.

Education constitutes the largest element of public expenditure in most developing countries and more than half of all investment in human capital.

## ii. Resource Allocation Processes

Resource Allocation processes comprise:

1. *Structure of domestic demand* consisting of: (a) Gross domestic investment as % of GDP; (b) private consumption as % of GDP; (c) government consumption as % of GDP, and (d) food consumption as % of GDP.

2. *Structure of Production* consisting of : (a) Primary output as % of GDP; (b) industry output as % of GDP; (c) utilities output as % of GDP; and (d) services output as % of GDP.

3. *Structure of Trade* consisting of: (a) Exports as % of GDP; (b) primary exports as % of GDP; (c) manufacturing exports as % of GDP; (d) services exports as % of GDP; and (e) imports as % of GDP.

Resource allocation processes produce systematic changes in the sectoral composition of domestic demand, international trade, and production as the income level increases. These patterns result from an interaction between the demand effects of rising income and the supply effects of changes in factor proportions and technology.

The three sets of resources allocation processes have a number of common features. Over the whole transition, per capita food consumption increases only half as much as per capita income due to the Engel effects. The corresponding decline in the share of food consumption leads to a doubling in the share of investment and large increase in non-food consumption. These shifts lead to a doubling in the share of industrial goods, apart from foodstuffs, in total demand over the transition.

The change in composition of demand is almost uniform in the allocation processes and of the composition of trade is the least uniform. While food consumption, primary exports and primary production decline almost uniformly, the growth of exports is not regular.

The change in the composition of exports is the reverse of composition of domestic demand. Primary exports decline while primary imports rise as percent of GDP. This reflects the shift in domestic

demand for primary products and the limited domestic supplies of natural resources and the slow growth of world demand.

With changes in the domestic demand and in trade reinforcing each other, the total change in the productive structure is more prominent. Similarly, the effect of population growth on the levels of imports and exports is quite evident. Value added in primary production falls considerably, nearly twice as much as there duction in food demand, whiletheriseofindustrialoutputismuchgreaterthanthe rise in domesticdemand.

Theshiftinthenormalpatternsofproductionshowsthatthesharesofprimary outputandindustrial output fall and tha to futilities and service srise. The fall in the share of primary output over and above the rising income, is due to technological progress and thesubstitution of industrial products for raw materials.

### **Self-Check Exercise 3**

**Q. Describe the three categories of Accumulation Processes?**

---



---



---



---

### **iii. Demographic and Distributional Processes**

Demographic and distributional processes include:

1. *Labourallocation* comprising (a) share of primary labour; (b) share of industry labour; and (c) share of servicelabour.
2. *Urbanisation* as urban percent of totalpopulation.
3. *Demographictransition* in (a) birthrate, and (b) deathrate.
4. *Incomedistribution* as (a) share of highest 20%, and (b) share of lowest

The distribution of income is influenced by level of education, structure of production and availability of government revenue for redistribution. It is also affected by a number of socio-economic processes like mortality, fertility and urbanization that are themselves correlated with the income level.

**(f) 1. Labour Allocation:** There are significant differences between the pattern of employment and pattern of structural change in production. They are:

(a) Demand for labour grows more rapidly in urban areas while the increase in supply of labour is more from rural areas.

(b) At the lowest income levels, the primary sector produces 52% of total output and provides 71% of employment.

(c) As income rises, the fall in the share of primary output is more rapid than the fall in employment in the primary sector. It reflects the concentration of investment and technological progress in industry and accumulation of surplus labour in agriculture.

**(g) 2. Urbanisation:** The relationship of the process of urbanisation to the level of development is about as uniform and stable as that of most other processes. Contrary to the popular impression that migration to cities has been fast increasing, Chenery's study shows no significant time trend. However, migration from rural to urban areas has been ahead of growth of demand for labour and has been determined increasingly by *expected* rather than current wages.

**(h) 3. Demographic Transition:** Early in the transition, fall in the death rate exceeds the fall in the birth rate, leading to maximum rates of population growth. But many demographic influences vary in importance according to the level of development. More education leads people to reduce birth rates where they are high but not where birth rates are already low at higher income levels. In less developed countries, both higher education and lower infant mortality lead to lower birth rates. However, urbanisation does not show a significant effect on the birth rate once the separate effects of education, income level and infant mortality have been allowed for.

4. *Income of Distribution:* Chenery divides income recipients into three groups: the top 20%, the middle 40% and the lowest 40%. His results show that the share of the lowest and the middle-income groups declines and that of the top group rises. In the early part of transition, income distribution worsens, when population growth is very high and the modern sector is too small to absorb a sufficient proportion of the growth of labour force. But with high levels of education, there is a shift of income away from the top 20% to the bottom 40%. Further, higher share of primary production has more equal distribution of income than industrial production.

## 5. Conclusion

Empirical studies on the process of structural change lead to the conclusion that the pace and pattern of development can vary according to both domestic and international factors, many of which lie beyond the control of an individual developing nation. Yet despite this variation, structural-change economists argue that one can identify certain patterns occurring in almost all countries during the development process. And these patterns, they argue, may be affected by the choice of development policies pursued by governments in developing countries as well as the international trade and foreign-assistance policies of developed nations. The structural change advocates therefore, suggest that the “correct” mix of economic policies be pursued by the developing nations as that would generate beneficial patterns of self-sustained growth.

## 6. Technical terms

- a) **Transition:** The process or a period of changing from one state or condition to another.
- b) **Diversification:** The process of a business enlarging or varying its range of products or field of operation.
- c) **Remittances:** The action of sending money in payment or as a gift.
- d) **Substitution:** The action of replacing something or someone with another person or thing.

**e) Reinforcing:** To strengthen or support

**7. Short answer type questions**

- A. Describe any two causes of reduction in inequality with development?
- B. Describe the Resource Allocation Processes?
- C. Describe the Demographic and Distributional Processes?

**8. Long answer type questions**

- A. Explain in detail Kuznets Inverted U- hypothesis?
- B. Explain Chenery's Pattern of Structural Change?

**9. Recommended Books**

The Economics of Development and Planning : M.L. Jhingan

Economic Development : Michael P. Todaro and Stephen C. Smith

Economics of Development and Planning : M.L. Taneja and R.M. Myer

---

**Theories of Institutional Change: Schumpeter and North**

- 1.5.1 Introduction**
- 1.5.2 Objectives of lesson**
- 1.5.3 Explanation of Schumpeter's theory**
- 1.5.4 Criticism of the theory**
- 1.5.5 North's Model**
- 1.5.6 Conclusion**
- 1.5.7 Short answer type questions**
- 1.5.8 Long answer type questions**
- 1.5.9 Recommended books**

**1.5.1 Introduction**

The innovations theory is associated with the name of Joseph Schumpeter. According to him, innovations in any economy are the source of economic fluctuations. Trade cycles are the outcome of economic development in a capitalist society. Professor Schumpeter believes that the fluctuations are inherent in the economic processes of industrial change. In his words, "If there be a purely economic cycle at all, it can only come from the way in which new things are in the institutional conditions of capitalistic society, inserted into the economic process and absorbed by it." Thus the fundamental cause of fluctuations according to Schumpeter is the periodic bursts of innovational activity. Innovations have been defined as the "changes in production function, which cannot be decomposed into infinitesimal steps." Then North gave model of institutional changes and economic growth.

**1.5.2 Objectives of lesson**

In this lesson we will study the Schumpeter's theory and North's model of economic development, how institutional changes can lead to economic development?

**1.5.3 Explanation of the theory**

In Schumpeter's approach innovations are the main institutional changes and this approach involves the development of his theory into two stages. The first stage deals with the initial impact of innovation and the second stage follows through reactions to the original impact of innovation.

We may distinguish here between inventions and innovations. While the former involve the discovery of novelties, innovations consist in the commercial exploitation of new techniques, new materials and new methods of organization.

The following activities can constitute innovations;

- (i) the introduction of a new product;
- (ii) the introduction of a new method of production ;
- (iii) the opening up of a new market;
- (iv) the control of a new source of raw materials or semi-manufactured goods;  
and
- (v) the new organization of an industrial structure.

The inventions differ in a marked way from the innovations that the former may be expected to appear on a more or less continuous basis over time and the output flowing from them proceeds in a much more even manner than that flowing from innovations. The innovations have the characteristic of discontinuity which means the tendency of innovations to assume swarm-like proportions, to appear in large clusters, instead of being evenly distributed through time. Schumpeter gives three main reasons for the cluster effect in the appearance of innovations:

- (i) There may be the social opposition to innovation that may range from quiet disapproval or quiet ostracism to an outright physical violence (ii) The banking system may be unwilling to finance new ideas and projects.
- (iii) There may be difficulties in training workers in new techniques.

So long these barriers exist, the process of innovations is greatly slowed down. But as soon as these barriers are lifted, there will be clusters of innovations involving a burst of investment activity. Thus innovations are essentially unperiodic and discontinuous and bring in wave-like movements in investment, production, employment, and income.

### **Assumptions of the theory**

1. Full employment in the economy.
2. Every firm is in equilibrium and producing efficiently with its cost equals its receipts.
3. Product prices are equal to average and marginal costs.
4. Profit and interest rates are zero.
5. There are no savings and investment.

The first approximation starts with the economic system in equilibrium with every factor fully employed. This equilibrium is characterized by Schumpeter as the circular flow which continues to repeat itself in the same manner year after year, similar to the circulation of the blood in an animal. In the circular flow, the same products are produced every year in the same manner. Schumpeter's model starts with the breaking up of the circular flow by an innovation in the form of a new product by an entrepreneur for earning profits. According to Schumpeter, there is nothing that can explain that inventions occur in a cyclical manner. It is the introduction of a new product and the continual improvements in the ones that

are the principle cause of business cycles.

Schumpeter assigns the role of an innovator not to the capitalist but to an entrepreneur is not a man of ordinary ability but one who introduces something entirely new. He does not provide funds but directs their use. To perform his economic function, entrepreneur requires two things:

- (1) The existence of technical knowledge in order to produce new products.
- (2) The power of disposal over the factors of production in the form of bank credit.

The innovating entrepreneur is financed by expansion of bank credit. Since investment in an innovation is risky, he must pay interest on it. With his newly acquired funds, the innovator starts bidding away resources from other industries. Money income increases, prices begin to rise thereby stimulating further investment. The new innovation starts producing goods and there is an increased flow of goods in the economy. Consequently, supply exceeds demand prices and cost of production of goods start declining until recession sets in. because of the low prices of goods, producers are not willing to expand production. During this period of recession credit, prices and interest rates decline but total output is likely to average larger than in the preceding prosperity.

Thus, Schumpeter's first approximation consists of a two phase cycle. The economy starts at the equilibrium state, rises to a peak and then starts downwards into a recession and continues till the new equilibrium is reached. This new equilibrium will be at a higher level of income than the initial equilibrium because of the innovation which started the cycle. This is shown as primary wave in Fig.1. The second approximation of Schumpeter follows through the reactions of the impact of original innovation. Once the original innovation becomes successful and profitable, other entrepreneurs follow it in "swarm- like clusters". Innovation in one field induces innovations in related fields. Consequently, money incomes and prices rise and help to create a cumulative expansion throughout the economy. With the increase in the purchasing power of consumers, the demand for the products of old industries increases in relation to supply. Prices rise further. Profits increase and old industries expand by borrowing from the banks. It induces a secondary wave of credit inflation which is superimposed on the primary wave of innovation. Over optimism and speculation further adds to the boom. After gestation period, the new products start appearing in the market displacing the old products and enforcing a process of liquidation, readjustment and absorption.

The demand for the old products is decreased. Their prices fall. The old firms contract output and some are even forced to run into liquidation. As the innovators start repaying bank loans out of profits, the quantity of money is decreased and prices tend to fall. Profits decline, uncertainty and risk increases,

the impulse for innovation is reduced and gradually comes to an end. Depression sets in and process of readjustment begins and natural forces of recovery bring about a revival.

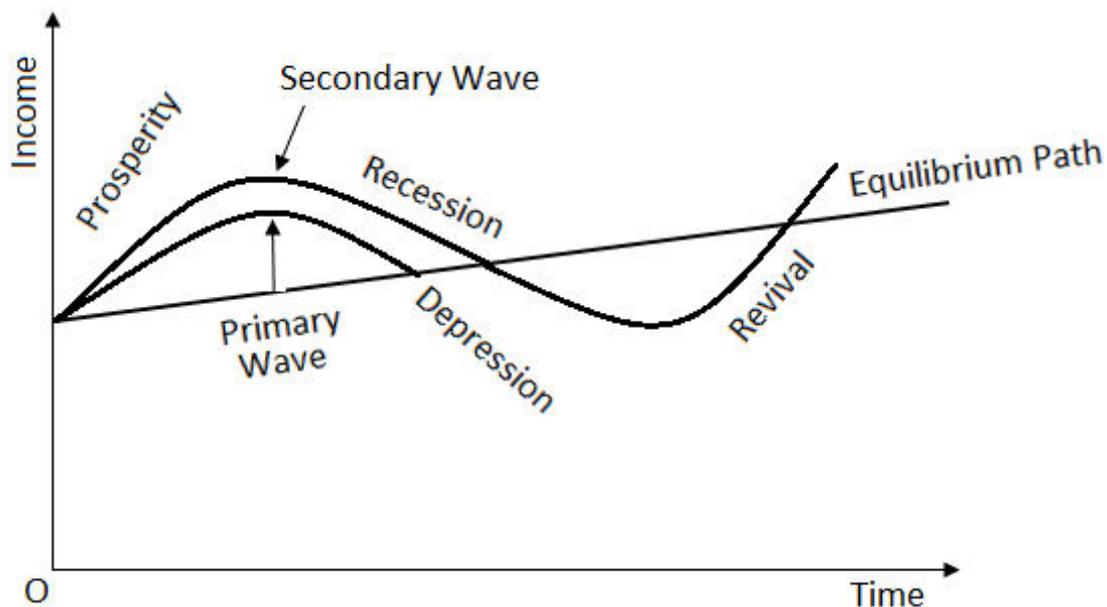


Figure 1

Schumpeter believes in the existence of Kondratieff long wave of upswings and downswings in economic activity. Each long wave upswing is brought about by an innovation which leads to abundance of goods. Once the upswing ends, the long wave downswing begins. Thus the second approximation of trade cycle develops into a four phase cycle with the recession which was the second phase in the first approximation continuing downwards to depression phase, this extension of cycle is followed by a period of revival which continues till equilibrium level is reached.

Now we turn to the explanation of the different phases of a business cycle. We start from the position of equilibrium in the economy where the amount of saving is just equal to investment and there is an absence of unemployment. Only a few among the entrepreneurs have the intelligence in capacity to make the commercial applications of the new possibilities with the use of bank credit. While only a few can lead, many can follow. The success of innovators will produce a swarm of imitators, who will emulate the successful innovation to avoid inroads into their profits and share of markets. New plants and equipments are installed and the construction activity is on the increase. Thus the familiar pattern of expansion is started as the investment activity is large then the current savings, the investible funds are supplied by the banking system through the creation of credit. The eruption of economic activity is not limited to the initiating firms and

their immediate competitors, but spreads also to the suppliers of raw materials and their competitors. Moreover, since there was full employment, to start with, the expansion of old firms or the setting up of new enterprises will involve the bidding up of the factor prices. This will push up the general price level, brightening further the prospect of profits and a forceful upswing will continue which is greatly reinforced by the optimistic expectations throughout the economy.

The peak of expansion is characterized by the innovators ceasing to innovate. Most of the new techniques have already been established; the new markets have been penetrated; all the new products which - were to be introduced have already made their appearance; and no new force of initiation or imitations is left. The surges of expansion will continue until the gestation lag does not expire. As the lag expires the new products intrude on economic world at an increasing rate and there occurs a state of over-production. This sets in a competition between the old and new firms, and between the firms producing old and new products and the competitive fire takes its toll on enterprises. Prices and profits decline and, anticipating a crisis, banking system restricts further advances and starts applying pressure for the recovery of outstanding advances. Such a process of readjustments brings about crisis or a state of recession.

The maladjustments that were built into the system during the very-process of innovational activity make themselves felt gradually and the economy moves on its downward course. Schumpeter himself regards depression as a reaction of earlier boom. He states that "depression is nothing more than the economic, system's reaction to the boom or the adaptation to the situation into which boom brings the system." The painful process of adjustment is marked by bankruptcies of firms which fail to get adjusted to the innovational changes that take place in their industries and also those firms which do adjust but find that their industry under the spell of innovations, has expanded capacity far beyond the market demand. The credit restraints imposed by the banking system too account for numerous bankruptcies leading to swelling unemployment. The repayments of old debts which were incurred by consumers and producers during the boom, initiate a wave of deflation which carries the system to lower and lower levels.

Schumpeter points out that the deflationary forces generated by depression are gradually off-set by certain other forces, one of which he terms as the 'dilution or diffusion of effects'. This is the effect of individual events like bankruptcies, shutdowns and collapses of individual markets upon the general economic activity. As the bankruptcies, unemployment or the like spread, their impact decreases at an increasingly diminished rate. Another off-setting force which Schumpeter calls "depression business" means that the collapse of some firms will enable the remaining firms to expand their operations in the additional spheres which were being catered to by the outgoing firms. Thus while there may

be losses and liquidations in some sectors, there may be, at the same time, gains and expansion in others. These off-setting influences may have a restorative effect, though Schumpeter himself seems to be skeptical of its quantitative magnitude. But the propensity to consume being less than unity, the decline in consumption throughout the downswing will be less than that in income. This will result in the depletion of inventories to the point where there is a need to replenish them. As the new investment takes place, some of the more adventurous entrepreneurs will again start to innovate. Others follow and investment surges up again in a spurt and another boom is on the way.

#### **1.5.4 Criticism of the theory**

Schumpeter's theory of business cycles is criticized for the following:

- (i) **Assumption of Full Employment:** It is based on the assumption of full employment of resources in the economic system so that the introduction of innovations will involve redistribution of factors and a consequent increase in factor prices. The withdrawal of labour and materials from old to new industries, brings about a reduction in the supply of old products and thereby contributes to recessionary conditions. This sequence of arguments will become irrelevant, if there is unemployment of labour and other factors because, in such a situation, the introduction of new innovations will not involve the withdrawal of labour and materials from other industries and the expansionary effect of innovations will not be as intense as can possibly be when there is full employment.
- (ii) **Innovation Not a Sufficient Condition:** Hayek has stated that innovations alone fail to explain cyclical fluctuations. It is the monetary variations which along with innovations usher in fluctuations in the system. If the entrepreneurs decide to finance innovations with their retained funds, the innovations can generate only very mild expansion. Similarly if the entrepreneurs rely upon the real savings for financing innovations, the inflationary pressures generated by bank credit will not be felt and the expansion, to a large extent, will be less intense.
- (iii) **Other influences on cycle:** The severity of depression is not governed by the disturbances caused by innovations alone. There are several other factors, such as the extent to which an innovation is introduced before the previous cycle has run its course, the amount of bank credit created by the banking system during the prosperity phase, the construction period necessary for innovations to be carried through, the competitive impact, which are crucial in determining the nature, intensity and periodicity of fluctuations. If innovations have been introduced in the latter phase of prosperity, the recession may be considerably delayed. Similarly if innovation is introduced by some adventurous entrepreneurs during the depression phase itself, many firms which may be on the verge of collapse, will get a fresh lease of life. The prices will be prevented from falling and thus prosperity will be initiated earlier. If the banking system extends very large amounts of credit

to finance innovations, the inflationary forces will be quite strong and greater will be the necessity to make readjustments in order to bring the prices into equilibrium. The longer or shorter gestation lag substantially affects the degree of readjustment that will have to be made. Longer the lag, greater the readjustments and more violent the fluctuations and vice-versa. Similarly impact of competition affects greatly the nature and extent of variations. If the impact of demand for the new product is quite widespread and the new-product reduces the demand of almost all other products, the distribution of this impact upon a very wide area, will mean that the fluctuation will be mild. If, on the other hand, the impact is confined only to a very few old products, the industries producing these products will suffer quite significantly and therefore fluctuation will be more pronounced. In addition, if the competitive impact is concentrated over a particular area, the unemployment of labour and other factors due to a lack of mobility will be much more serious than in a situation when the impact is spread over a vast area.

### **1.5.5 North's Model**

#### **Introduction**

North says that for economic development not only economic factors are required but so many non-economic factors are also required like social, political, administrative, religious and cultural factors. Let us begin on a positive note. Briefly stated, the model specifies the process by which an action group (an individual or group) perceive that some new form of organization (institutional arrangement) will yield a stream of benefits which makes it profitable to undergo the costs of innovating this new organizational form. These new arrangements have typically been profitable to realize potential economies of scale, reduce information costs and spread risk. These institutional arrangements account for a vast array of the "economic institutions" with which economic historians have traditionally been concerned. However, the formation (and mutation and decay) of these organizational forms cannot be an integral part of the economic analysis rather than a descriptive addition to the analysis. Moreover, since a great many were realizable without substantial redistribution of income, their formation is at least in principle predictable from the model. Perhaps even more significant than the ability to integrate economic analyses and institutional formation is the implication of this theoretical model for the study of productivity increase. Economic historians have focused on technological change as the source of growth but the development of institutional arrangements from the above mentioned sources are a major historical source of the improvement in the efficiency of product and factor markets. The development of more efficient economic organization is surely as important a part of the growth of the Western World as is the development of technology, and it is time it received equal attention. The few cases of which he said that he was aware that have attempted

to measure productivity change attributable to improving economic organization certainly support this contention.

Yet not all of the potentially "productive" institutional arrangements are so predictable. If such potentially new organizational forms involve income redistribution so that there are substantial losers as well as gainers, and the losers are not compensated, then the outcome is indeterminate. He said that it cannot be told, a priori, whether the losers will be able to thwart the new arrangement or not. Yet, despite this severe stricture, he can at least expect that such potential profits will lead to efforts to form such an institutional arrangement, even though we cannot predict the outcome. Institutional arrangements to realize gains from the above mentioned sources were organizational innovations in which total output was increased as a result of the improvement in productivity. Yet, not all institutional arrangements are of this type. It has been equally profitable, and frequently more rewarding, to devise arrangements to redistribute income. In such cases, output is not increased and more frequently total output falls. Institutional arrangements of this type necessarily involve coercion and since government is the only legal source of coercion, more often than not, they are a product of legislation or government fiat. The ability of voluntary associations to redistribute income usually requires that they be able to effectively limit entry in a product or factor market.

### **Choice between innovating institutional arrangements**

The choice between innovating institutional arrangements of a voluntary form or through government raises a number of issues and many of them are still unresolved. Both the productive and redistributive (and combinations of both) institutional arrangements may be of either type although we noted that if substantial losses were imposed on individuals or groups in society that government coercion was involved directly or by delegation. The relative benefits of governmental versus voluntary institutional arrangements have varied over time with changes in the coercive power of government and changes in the costs of getting "stuck" with government decisions. The distinction between voluntary associations and government alone is more complicated.

The usual distinction is that voluntary associations are governed by a unanimity rule and withdrawal is voluntary whereas governmental organizations exist by an arbitrary decision rule (usually a simple majority), withdrawal is not permissible and the government is uniquely endowed with coercive power. In fact, voluntary association may not operate under a unanimity rule. Individuals in the association may disagree with the association's policies, but as long as the costs of withdrawal exceed the costs of the decision, they will remain. Moreover, one may withdraw from a government arrangement by migration. To make the distinction even muddier, many voluntary associations are profitable only because they have the coercive power of legal sanction behind them. The

advantages of the corporation are derived from its legal characteristics. In fact, he finds historically that institutional arrangements run the whole gamut from "pure" voluntary to mixed to "pure" governmental. In order to clarify further the basic characteristics of institutional arrangements, the economic historian is going to have to become deeply immersed in legal history. Unfortunately, since he will seldom find legal historians asking the questions he wants answered, he will not find complete satisfaction in the existing literature.

### **Relationship between secondary and fundamental institutional arrangements**

While there is typically some overlap between them, the most obvious difference is that the latter are far more costly to alter than the former, and that historically this has been the intention of framers of constitutions. The economic changes which produce disequilibrium in the system and therefore profitable opportunities to innovate secondary institutional arrangements may ultimately induce changes in the fundamental institutional environment, but the obstacles to devising a precise model to predict such changes are formidable.

When we turn to American history we find that formal changes in the Constitution through amendment has not only been very costly, as its framers intended, but also has not been the main avenue by which changes in the fundamental institutional structure have occurred, which its framers may not have intended. It is not that changing Supreme Court interpretations of the Constitution are not related to the changing economic environment; it is simply that the lagged response defies any simple explanation.

### **Limitations of model**

Before we proceed further, we should note two limitations to this model of the formation of secondary institutional arrangements. The model is predicated on profit maximization in which the guiding force in the innovation of an institutional arrangement is the private profitability to the primary action group and the model also assumes that individuals will acquire the necessary information to act "rationally" as long as it is profitable for them to do so (that is, until the benefits and costs are equated at the margin). Yet, neither assumption always holds. Individuals and groups have devised institutional arrangements for the benefit of others. Social reformers endeavour to redistribute income in favor of low-income groups. The negative income tax for example has been promoted, for the most part, by individuals and groups who stand to lose from its enactment. Secondly, people frequently act in terms of general ideological positions rather than incur the costs of acquiring information on a particular issue even when it would pay them to do so. Thus, they react as liberals, conservatives, radicals, or reactionaries. Ideologies are a way of economizing on the costs of information and therefore are in general a rational response to the costs of information about the broad range of issues that face them. But this does lead people, frequently, to act

against their own self-interests about a particular issue. Thus the weight of existing evidence would suggest that it is not in the interests of a poor black to favour higher minimum wage legislation even though it is likely a substantial majority of them do favour such legislation.

Up until now we have been talking about secondary institutional arrangements which are innovated in the context of the "fundamental rules of the game." These basic ground rules consist of the decision rules that govern the making of non-market decisions and the structure of property rights that define and specify competitive and cooperative relationships in the market place. These basic ground rules may exist as a written constitution, as a body of written law, by custom, or as a combination of all three. There is usually a formal and typically very costly procedure for amending those that are in written form.

### **Three tentative propositions for further research**

With a rise in the benefits to be gained from altering the fundamental institutional environment, secondary institutional arrangements will be innovated at a much lower cost than changing the fundamental institutional arrangements. These secondary institutional arrangements will attempt to capture these potential profits by circumventing (and in some cases by illegally violating) the strictures of the basic decision rules.

1. Accumulation of such secondary institutional arrangements will lower the cost of attempting to effect a change in the basic decision rules.
2. Since changes in the basic decision rules typically redistribute wealth, income, and political power, we cannot make a predictive statement about the outcome given the present state of the theory.
3. When conflict arose amongst groups over fundamental institutional arrangements, there was an incentive for the group that achieved the power to make the changes to impound these new rules in a written constitutional document which was very costly to alter. This would occur if a group envisions that its decision-making ability with respect to the basic decision rules might not be permanent.

It is one question to ask how the basic institutional environment is formed and modified. We need to know much more. It is still another question to ask what the consequences are of any set of basic decision rules. While scholars have devoted (and quite rightly so) a great deal of attention to the growth of the political decision rules, their primary attention has been for its consequences for representative government. However, the consequences of both the political and economic decision rules for their effect on economic growth has, until quite recently, been neglected. Yet, and he will state it baldly, it is his conviction that economists have misdirected their efforts in the past twenty-five years in their search for the explanation of economic growth. The answer does not lie in the narrow economic confines of their models of capital formation or any of the other

"strategic" variables that have variously come to the fore; the answer lies in the characteristics of the basic institutional environment and the degree to which these basic ground rules are enforced. If these rules lower the cost and raise the benefits of institutional arrangements which redistribute income relative to those that encourage (by profitable incentive) institutional arrangements which increase output, then that society will devote its energies accordingly. If, on the other hand, the reverse is correct, then economic growth will occur.

He wished to encourage man to devote his energies to productive activities. In retrospect, it is hard to fault their theory, and the nineteenth century would appear to provide at least good initial presumptive evidence to support their contention. While it is obvious that the political decision rules can make redistributive institutional arrangements more or less costly, it does not appear to have been equally obvious that the structure and enforcement of property rights will either encourage or discourage productive economic activity. To the degree that property rights make the private rates of return come closer to the social rate, they will provide the appropriate incentives for economic growth. They must be so devised that the social benefits and costs of the actions of individuals and groups are borne by those undertaking those actions whether it is in innovation, child bearing, or in their contribution as factors of production. In short, these basic decision rules must encourage and enforce contractual relations (secondary institutional arrangements) that encourage socially beneficial consequences. It is my contention that the failure to devise and enforce such basic decision rules is the source of the poor performance of economies in the past and in the present.

### **1.5.6 Conclusion**

In this lesson we have studied the Schumpeter's theory of trade cycles, that how innovations can lead to trade cycles. Despite the shortcomings, Schumpeter's treatment is quite fascinating because it attempts to treat cycles in relation to economic growth. Moreover it combines the endogenous and exogenous business cycle factors in a commendable way. The North's model specifies the process by which an action group (an individual or group) perceive that some new form of organization (institutional arrangement) will yield a stream of benefits which makes it profitable to undergo the costs of innovating this new organizational form.

### **1.5.7 Short answer type questions**

1. Which are the activities that can constitute innovations?
2. What are three main reasons for the cluster effect in the appearance of innovations?
3. Distinguish between inventions and innovations.
4. What are the main assumptions of Schumpeter's theory of trade cycle?
5. Explain the three rules given by North.

**1.5.8 Long answer type questions**

1. Critically examine Schumpeter's theory of trade cycles
2. How innovations can lead to trade cycles?
3. Critically evaluate North's model.

**1.5.9 Recommended books**

|                                  |   |   |
|----------------------------------|---|---|
| Macroeconomics                   | : | John.H.Makin                            |
| Business cycles                  | : | J. A. Schumpeter                        |
| Michael P. Todaro                | : | Economic Development in the Third World |
| Gerald M.Meier                   | : | Leading Issues in Economic Development  |
| Chenery,H. And<br>T.N.Srinivasan | : | Handbook of Development Economics Vol.1 |

---

**Dependency Theory of Development–I Paul Baran's and  
Andre Gunder Frank****1.6.1 Introduction****1.6.2 Objectives of lesson****1.6.3 Paul Baran's analysis of economic backwardness and economic growth****1.6.4 Andre Gunder Frank's analysis of development of underdevelopment****1.6.5 Summary****1.6.6 Short answer type questions****1.6.7 Long answer type questions****1.6.8 Recommended Books****1.6.1 Introduction**

Dependency theory is the notion that resources flow from a "periphery" of poor and underdeveloped states to a "core" of wealthy states, enriching the latter at the expense of the former. It is a central contention of dependency theory that poor states are impoverished and rich ones enriched by the way poor states are integrated into the "world system". The theory arose as a reaction to modernization theory, an earlier theory of development which held that all societies progress through similar stages of development, that today's underdeveloped areas are thus in a similar situation to that of today's developed areas at some time in the past, and that therefore the task in helping the underdeveloped areas out of poverty is to accelerate them along this supposed common path of development, by various means such as investment, technology transfers, and closer integration into the world market. Dependency theory rejected this view, which arguing that underdeveloped countries are not merely primitive versions of developed countries, but have unique features and structures of their own; and, importantly, are in the situation of being the weaker members in a world market economy. Dependency theory no longer has many proponents as an overall theory, but some writers have argued for its continuing relevance as a conceptual orientation to the global division of wealth.

The premises of dependency theory are that:

1. Poor nations provide natural resources, cheap labour, a destination for obsolete technology, and markets for developed nations, without which the latter could not have the standard of living they enjoy.
2. Wealthy nations actively perpetuate a state of dependence by various

means. This influence may be multifaceted, involving economics, media control, politics, banking and finance, education, culture, and sport.

Dependency theory originates with two papers published in 1949 – one by Hans Singer, one by Raúl Prebisch – in which the authors observe that the terms of trade for underdeveloped countries relative to the developed countries had deteriorated over time: the underdeveloped countries were able to purchase fewer and fewer manufactured goods from the developed countries in exchange for a given quantity of their raw materials exports. This idea is known as the Singer-Prebisch thesis. Prebisch, an Argentine economist at the United Nations Import-substitution industrialisation (ISI), not a trade-and-export orientation, was the best strategy for Commission for Latin America (UNCLA), went on to conclude that the underdeveloped nations must employ some degree of protectionism in trade if they were to enter a self-sustaining development path. He argued that underdeveloped countries. The theory was developed from a Marxian perspective by Paul A. Baran in 1957 with the publication of his *The Political Economy of Growth*. Dependency theory shares many points with earlier, Marxist, theories of imperialism by Rosa Luxemburg and V.I. Lenin, and has attracted continued interest from Marxists. Matias Vernengo, a University of Utah economist, identifies two main streams in dependency theory: the Latin American Structuralist, typified by the work of Prebisch, Celso Furtado and Anibal Pinto at the United Nations Economic Commission for Latin America (ECLAC, or, in Spanish, CEPAL); and the American Marxist, developed by Paul A. Baran, Paul Sweezy, and Andre Gunder Frank.

### **1.6.2 Objectives of lesson**

In this lesson we will study:

- Paul Baran's analysis of economic backwardness and economic growth
- Andre Gunder Frank's analysis of development of underdevelopment

### **1.6.3 Paul Baran's analysis**

Paul Baran has given political economic explanation of economic backwardness and economic growth. He has developed the theory of dependency on the Marxist tradition. His theory is basically the Marxist theory of economic development, as it originated in Marx's own writing on the origins, development and contradictions of capitalism. Baran expressed his ideas at three main places, namely, in his article. "On the Political Economy of Backwardness", The Manchester School (January 1952), in his book, *The Political Economy of Growth*, Monthly Review Press (1957) and in the book that he wrote with Paul M. Sweezy on *Monopoly Capital*, Monthly Review Press (1966). Paul Baran observes that the analysis of development and underdevelopment comes within the jurisdiction of political economy. Baran placed surplus extraction and capital accumulation at the center of his analysis. Development depends on a population's producing more than it needs for bare subsistence (a surplus). Further, some of that surplus must be

used for capital accumulation - the purchase of new means of production - if development is to occur; spending the surplus on things like luxury consumption does not produce development. Baran noted two predominant kinds of economic activity in poor countries. In the older of the two, plantation agriculture, which originated in colonial times, most of the surplus goes to the landowners, who use it to emulate the consumption patterns of wealthy people in the developed world; much of it thus goes to purchase foreign produced luxury items—automobiles, clothes, etc. -- and little is accumulated for investing in development. The more recent kind of economic activity in the periphery is industry—but of a particular kind. It is usually carried out by foreigners, although often in conjunction with local interests. It is often under special tariff protection or other government concessions. The surplus from this production mostly goes to two places: part of it is sent back to the foreign shareholders as profit; the other part is spent on conspicuous consumption in a similar fashion to that of the plantation aristocracy. Again, little is used for development. Baran thought that political revolution was necessary to break this pattern.

### **Essential Features of Paul Baran's Analysis**

Baran's analysis considers that economic questions cannot be separated from social, political, and ideological ones; and he takes the world as a group of developed and backward capitalist countries and socialist countries which all interrelate with one another.

Baran has discussed different types of economic relationships between developed and underdeveloped countries within the capitalist system. He has observed that while in the advanced countries, capitalism leads to stagnation or militarism or both, in the underdeveloped countries, it strangles all efforts at economic development. Baran is of the view that underdevelopment is rooted in the same earth as development; they are the common results of a world-wide process of capital accumulation.

He explains that capitalist mode of production during the latter part of the eighteenth century and also during the entire nineteenth century was able to expand productivity and material welfare quite sufficiently in different parts of the world. But the material progress was not equally distributed in space. Most of the material gain was confined to the Western countries; it did not affect the less developed countries. In other words, one type of countries could gather enormous surplus and became economically developed, and the other type of countries could not gather surplus; rather, their own surplus was taken away by the other type of countries who became later developed countries. He shows that neither development nor underdevelopment could be understood unless the global interdependence of these two types of countries is taken into account. Economic development in LDCs is profoundly inimical to the dominant interests of the DCs. In fact, the exploitation of the LDCs has played an important role in the

development of Western capitalism. In this connection, Paul Baran has defined growth as an increase of per capita material goods over time. This is a concept of quantitative growth.

### **Sources of economic growth**

There are mainly three sources of economic growth.

- i. Firstly, growth may be achieved by fully utilising the unutilised resources like population, land, capital and so on.
- ii. Secondly, growth can also be achieved by making some organisational changes. This involves - the shifting of resources from less productive uses to more productive uses, and
- iii. Thirdly, by providing a better technology and capital, growth can also be attained. It is clear by now that in order to have economic growth, it is necessary to have better technical knowledge and higher rate of growth of investment. Since these two factors are not sufficiently available in LDCs, these countries remain underdeveloped.

Economic growth essentially depends on the accumulation of surplus and its proper utilisation. Thus, it is necessary to properly analyse the question of surplus in this connection.

### **Types of economic surplus**

There are three main types of economic surplus. These are:

- i. Actual Economic Surplus,
- ii. Potential Economic Surplus, and
- iii. Planned Economic Surplus.

Actual surplus is the difference between society's actual current output and its actual current consumption. The potential surplus is the difference between what the society could produce in a given natural and technological environment with the help of employable productive resources, and what might be regarded as the necessary consumption. Potential surplus is generally bigger than the actual surplus in a capitalist society. Planned surplus is the difference between the society's optimum output attainable in a historically given natural and technological situation obtainable in a planned economy and the optimal volume of consumption. Planned surplus is relevant in a planned economy under socialism.

As has been pointed out earlier, the realisation of potential surplus needs some organisational changes. The actual surplus is nothing but the current saving or capital accumulation. The optimum production and consumption are to be determined under the ideal conditions of a planned economy like socialism. Under socialism, economic surplus is not determined by the consideration of profit maximisation but by the stage of historical development and also by the degree of development of productive forces and the structure and growth of human needs.

According to Baran, the really important concept is not the actual economic surplus but the potential economic surplus. The concept of potential economic surplus includes the consumption spending of the state and the unnecessary consumption of the workers and capitalist. Potential surplus is really the surplus which could be used for economic development with a different organisational set-up. Baran asserts that potential surplus rises during the development of monopoly capitalism, as has been found from experience.

Baran's concept of surplus is different from Marx's concept of surplus value. Whereas, Marx has analysed surplus value in relation to the ownership of means of production. Baran has analysed surplus in relation to consumption needs of the society. Baran argues that DCs paradoxically generate an ever-increasing surplus, while at the same time failing to provide the consumption and investment outlets required for its absorption. The DCs impose a particular form of development on the colonies in which the economic surplus produced is appropriated by foreign firms and domestic comprador class to the detriment of the colonial countries. The loss of surplus from these countries has made them underdeveloped. According to Baran, the problem for the DC is one of an overproduction of economic surplus, but for the developing countries, the problem is the lack of access to surplus for their economic development.

LDCs are underdeveloped because they have lower production and because the degree of utilisation of human and material resources has also been lower there. Underdevelopment and underutilisation of resources go hand in hand. The capitalist frame-work that is existing there is responsible for the economic stagnation and archaic technology of these poor countries. The size of economic surplus in such countries is very low. This is not due to higher consumption but due to small scale production and exploitation by the capitalists. Moreover, these countries have low capital endowment, low productivity, low saving and rapid growth of population. Whatever capital LDCs receive from abroad, is designed to extract surplus from these countries by the foreign capitalists. Whenever an increased national income takes place, it does not benefit the common people because of the system of skewed distribution.

The introduction of capitalism in LDCs does not do much good but it does enormous harm to these countries by generating economic and social tensions which are inherent in the capitalist order. Such an order effectively disrupted whatever was left of the feudal system of the backward countries. Capitalism substituted market contracts for the paternalistic relationships which existed in these countries in the past. Capitalism forced the LDCs to produce marketable raw materials for the DCs. Such countries also became the markets for the finished products of the DCs. In this way, the LDCs were linked with the vagaries of world capitalist market. The imported capitalism superimposed some business ethics which resulted in exploitation, corruption and injustice. The new machines

worked for their foreign owners and not for the benefit of the domestic population. The wealthy business people reaped immense profits but did not utilise them for productive purposes. What resulted was an amalgam combining the worst features of both feudalism and capitalism, and it blocked all possibilities of economic growth in LDCs.

The LDCs, are mainly the agrarian economies, the majority of the population depended on agriculture. The share of surplus that accrued to the landowning class was not utilised for economic development. The surplus produced from agriculture was utilised in excess consumption. The landowning class spends huge amount of money for conspicuous consumption on luxury articles, on servants, on entertainment and travels. The landed aristocracy does not spend money for the improvement of agriculture. The situation is still worse for the small farmers who cannot introduce modern technology for want of funds and also due to small size of land-holdings. This is the reason behind the breaking down of large estate into small holdings. Land reforms may bring about some short-term benefits in the form of income increase to the farmers, but in the long-run, such benefits will be wiped out as a result of an increase in population. An increase in population will necessitate further partitions of land holdings into smaller plots.

The induction of capitalism in the domestic economy destroys the rural handicrafts and cottage industries. And this leads to the dissolution of the pre-capitalist structure of the economy and it also disintegrates the natural self-sufficiency of the domestic economy. However, this is a general possibility. It may not be true for all types of underdeveloped countries. But one thing which becomes clear is that when foreign goods are imported from abroad, the possibility of domestic production of those goods is reduced, and the size of the market becomes limited.

The introduction of the monopolistic type of industry in the domestic economy of the dependent country puts an obstruction to the growth of industrial capitalism. In such a situation, the transition of capital from the sphere of circulation to the sphere of production becomes pretty difficult. Under such a situation, agricultural growth becomes stagnant, and structural unemployment becomes a reality. The basic point in the explanation of underdevelopment in the schema presented by Baran is that the economic surplus which is appropriated by the monopolistic firms is not utilised for the purpose of economic development and for increasing production. Economic surplus is dissipated by the monopolists in unproductive manners. Only a small amount is spent for the purchase of rent-bearing property, in speculation and in usury. Baran has also pointed out that a large amount of money is sent abroad as hedges against the depreciation of the domestic currency or as nest eggs assuring their owners of suitable retreats in the case of social and political upheavals at home. The foreign firms do not bother about capital formation in the underdeveloped countries. On the other hand,

most of the foreign firms send their profits abroad from the country in which they are engaged in business. Sometimes the profits are sent to those countries abroad where the rate of return on investment is higher. Generally, the profits of one underdeveloped country are not sent to another underdeveloped country; but instead, the profits are sent from one underdeveloped country to a developed country in the form of investment. It has been rightly pointed out that the main effect of foreign capital on the development of underdeveloped countries lies in hardening and strengthening the swag of Merchant Capitalism which slows down and indeed prevents the transformation of Merchant Capitalism into Industrial Capitalism. He is of the opinion that unless Merchant Capitalism is transformed into Industrial Capitalism, there cannot be any economic development in the true sense of the term.

The main obstacle in the way of economic development in LDCs is the lack of proper utilisation of surplus. Another reason is the availability of a very low volume of surplus. Development cannot be initiated because there is the deficiency of investment opportunities in such countries. This difficulty largely arises from the structure and the limitations of the existing effective demand simply because of low income. Most of the money out of low income is spent on food and other basic necessities of life. Only a small amount is left out for investment, which is inadequate. Moreover, it does not appear to be profitable to start major enterprises only for a small number of rich people. These people generally import the luxury goods of snob values from abroad. In such a case, there is no point in developing major industries at home. The limited demand for investment goods also precludes the building up of a machinery or equipment industry. All this leaves the expansion of exportable raw material output as a major outlet for investment activities in LDCs.

However, there may be many difficulties in the matter of export. These are: uncertainty about foreign demand, prices and output of other countries which are competing. All this will sharply reduce the interest of the native capitalist in the business of export. The most important difficulty in the way of economic development in underdeveloped countries is the shortage of investable funds and the lack of investment opportunities. However, they represent two aspects of the same problem. Moreover, investment in such countries is a new experience. Mostly, the new investments cannot be expected to reap external economies. The absence of external economies, the inadequacy of the economic milieu in LDCs constituted everywhere an important deterrent to investment in industrial projects. Investment really depends on some previous investment. Baran rightly says that large scale investment is predicated upon large-scale investment. Before any investment is made, there must be proper infrastructure. Moreover, the business people in LDCs are not exposed to big businesses. Their financial resources are too small for ambitious projects, but they do not have the habit of entering commitments. These people are not habituated in sinking funds in

enterprises where profitability is unattractive and risk is high.

In the field of agriculture, the fallow lands can be brought to cultivation only after making considerable investment. Agriculture also requires a lot of innovations. But the peasants in LDCs are utterly unable to pay for such innovation. They do not have the financial ability to import costly equipments for the development of agriculture. Agriculture can be partly improved by the establishment of industries like fertilizers, electric power and so on. But in such countries, the prospect of industrial development is also limited. Monopolistic market structure, shortage of savings, lack of external economies and the divergence of social and private rationalities are the basic obstacles in the way of development of underdeveloped countries. These obstacles have to be considered against the background of the general feeling of uncertainty prevailing in backward areas. Moreover, there are many types of inherent instability of the political and social order. Peasant uprisings, strikes and local guerrilla warfare from time to time are the grim reminders of the latent crisis in such countries. This type of climate is not congenial for making investment in long-term projects.

#### **Four fallacies**

Baran has brought out four important popular fallacies which are cited while discussing obstacles to economic development.

- i. It is wrongly said that lack of entrepreneurial talent is one of the main obstacles in LDCs. According to Baran, this is not true. There are many good entrepreneurs in LDCs.
- ii. It is not true to say that there is lack of capital in LDCs. He is of the opinion that potential surplus available in LDCs is quite large
- iii. Population problem is a serious menace to economic development in LDCs. He believes that relative overpopulation can be judged only with reference to the means of production. Like Marx, Baran points out that overpopulation has to be considered only with reference to the means of production and employment.
- iv. Falling terms of trade are responsible for economic underdevelopment. If the prices of the domestic commodities rise, it will benefit only the foreign exporters who are operating in the domestic economy, and it will mean a transfer of larger amount of profit abroad by the foreign capitalists.

We can now summarise the basic arguments of Paul Baran for explaining the situation of underdevelopment. The central point of Baran's analysis is that the main obstacle to the rapid growth of LDCs is the way in which their potential surplus is utilised. The size of the surplus does not matter so much. Baran argues that much of the potential economic surplus is not realised. Secondly, much of the realised economic surplus is misused by those who appropriate it. A large part of the surplus is spent for maintaining unemployed labour and excess industrial

capacity, and also in wasteful expenditure and in consumption stimulated by the international demonstration effect imposed by the multinational corporations. The wasteful and luxury expenditures are made by landlord and capitalist classes. These classes include moneylenders, landlords, and merchants. The state is also responsible for heavy expenditures on police and military forces. Apart from all these, much of the realised surplus goes out of the countries in the form of profit repatriation by foreign capitalists or service payment on the foreign debt, or as capital flight by the local elite who hold deposits overseas. Finally, if an underdeveloped country tries against all odds to overcome its underdevelopment, it is likely to find that its efforts are frustrated by the animosity of imperialism towards all genuine initiative at economic development on the part of the underdeveloped countries. The Centre tries to keep the periphery under its firm control.

Baran has shown that the penetration of capitalism into a feudal economy was an important obstacle for economic development. The local power structure and the foreign capitalists combined in a very palpable manner to fleece the people and the country. The surplus which could be utilised for development went out of the country. And the combination of local feudalism with capitalism blocked all possibilities for economic development.

Baran has discussed the possibilities of economic development of underdeveloped countries. Baran observes that it is essential first of all to have a social revolution, but this will inevitably encounter the hostility of the imperial power. The establishment of a socialist planned economy is also essential for economic and social progress of underdeveloped countries. It is very necessary to mobilise the potential economic surplus of a country. A number of steps like the expropriation of foreign and domestic capitalists and land owners, elimination of capital, drain, restriction of consumption, flight of capital to foreign countries and so on have to be applied. In this way, sufficient resources can be made available for the generation of new productive employment. Nonessential imports should also be banned and transfer of funds can be restricted. This will also be helpful in the mobilisation of resources for productive uses.

In a planned economy, there will be the growth of planned economic surplus. This can be equitably distributed among the population of the country in such a way that it leads to optimum social and material development of the country in the long run. In a socialist type of development, both agriculture and industry can be simultaneously developed. Regarding the method of development to be adopted, one has to remember the planned objectives of the country.

Agricultural development can be achieved by the use of improved seeds, improved methods of irrigation and also by improved usage of better inputs like fertilizers and so on. Substantial increase in productivity and output will depend on the

possibility of introducing modern type of machinery, power and schemes of specialisation. It will be necessary to productively employ the unemployed and underemployed labour force of the country. For all these, a substantial amount of investment becomes essential.

### **Measures taken up by government to overcome economic backwardness**

A number of measures can be taken up by the government for over-coming economic backwardness.

- i. The government has to take up those lines of production which is not favoured by the private sector. The government has to start production and encourage competition where there is monopoly and restriction.
- ii. State has to build-up the proper infrastructure for making further investment profitable.
- iii. It is necessary to check the inflationary pressure through proper monetary and fiscal policies.
- iv. A proper type of progressive taxation has to be introduced for not only controlling inflation but also for eliminating wasteful consumption and expenditure on non-essential activities.
- v. Government needs to open technical schools for imparting skill and also for the growth of human capital formation. A proper system of education would be necessary for devising a right type of planning for economic development of an underdeveloped country.

It would be essential to properly control the foreign exchange resources of the country and to restrict the use of the limited supply of foreign exchange. Foreign aid has to be used with care because aid, like trade, may be very harmful at times for LDCs. The social and political climate of the country also needs to be drastically revamped in such a way that common people are benefitted.

### **Critical Appraisal**

A number of criticisms can be levelled against Baran's analysis.

- i. Baran's theory as given in his *Monopoly Capital* (1966) which was written with Sweezy, was criticised principally because it departed from Marxist tradition, by utilising the concept of economic surplus rather than surplus value for an examination of advanced capitalist economies.
- ii. It is practically very difficult to distinguish between his concepts of potential surplus and planned surplus. This is so because both these types of surplus arise only after some necessary changes by the authority. And these changes are mostly done through some sort of planning, even if the country is not fully socialist in character.
- iii. Kaldor in his review of Baran's book (1957) said that the whole thesis of Baran hinges on the theory of distribution. But unfortunately, Baran has not given any discussion on the theory of distribution.

- iv. Kaldor cast doubt on Baran's contention that monopoly capital in its Mature stage led to a restriction, of the rate of technical advance or to a slower growth of the purchasing power of the masses.
- v. Fifth, in his Manchester School paper (1952), Baran says that one of the causes of underdevelopment is low saving and high consumption. This is not factually true in most of the underdeveloped countries. For instance, in a country like India, saving forms nearly 12 per cent of the national income and this is mostly contributed by the private sector. Similarly, the consumption level of the poor people of these countries is not at all very high, although a small section of the population may be engaged in conspicuous consumption.
- vi. Baran had not sufficiently relate the facts of exploitation in the DCs and LDCs to the aid, trade and exchange relationships which he discusses in various parts of the book (1957). Indeed, he did not really have a theory of exploitation at all, though, of course, he never lost sight of the harmful effects of the capitalist system on large section of the population of DCs, not to mention the LDCs. According to R.B. Sutcliffe, this was an important theoretical omission when it comes to taking a political message from the economic situation which Baran elaborated.
- vii. Baran did not consider the mechanism which causes the transition from actual to either potential or planned surplus, and vice versa.
- viii. Baran has advised for the establishment of a socialist society. However, socialism, as historical experience shows, is not a panacea. In many countries of our times, socialism has really failed.

Baran came equipped with a theory which saw underdevelopment in a global perspective and yet which could distinguish the position of the advanced country from that of an underdeveloped country. His insights had given enormous influence on the ideas of the radical economists. His analysis of potential surplus has encouraged writers to explore the possibilities of self-reliant development and to investigate ways in which the surplus is generated and siphoned off to the rich countries. His analysis has given a new direction for the examination of the links among the domestic class structure, international dependency and capital accumulation. Baran has made a definite contribution towards the development of Marxist theory.

#### **1.6.4 Andre Gunder Frank's Analysis of Development of underdevelopment**

Gunder Frank has extended the analysis of Paul Baran. Baran, Frank and others of the dependency school argue that underdevelopment arose from the way the Third World was incorporated into an international economic and political system, dominated initially by Europe and later by the United States. After Baran, Frank is the most noted writer of the dependency school of thought. He carried and generalised Paul Baran's analysis to its logical conclusion.

### **The Central Propositions of Dependency Theory**

There are a number of propositions, all of which are contestable, which form the core of dependency theory. These propositions include:

1. Underdevelopment is a condition fundamentally different from undevelopment. The latter term simply refers to a condition in which resources are not being used. For example, the European colonists viewed the North American continent as an undeveloped area: the land was not actively cultivated on a scale consistent with its potential. Underdevelopment refers to a situation in which resources are being actively used, but used in a way which benefits dominant states and not the poorer states in which the resources are found.
2. The distinction between underdevelopment and undevelopment places the poorer countries of the world in a profoundly different historical context. These countries are not "behind" or "catching up" to the richer countries of the world. They are not poor because they lagged behind the scientific transformations or the Enlightenment values of the European states. They are poor because they were coercively integrated into the European economic system only as producers of raw materials or to serve as repositories of cheap labour, and were denied the opportunity to market their resources in any way that competed with dominant states.
3. Dependency theory suggests that alternative uses of resources are preferable to the resource usage patterns imposed by dominant states. There is no clear definition of what these preferred patterns might be, but some criteria are invoked. For example, one of the dominant state practices most often criticized by dependency theorists is export agriculture. The criticism is that many poor economies experience rather high rates of malnutrition even though they produce great amounts of food for export. Many dependency theorists would argue that those agricultural lands should be used for domestic food production in order to reduce the rates of malnutrition.
4. The preceding proposition can be amplified: dependency theorists rely upon a belief that there exists a clear "national" economic interest which can and should be articulated for each country. In this respect, dependency theory actually shares a similar theoretical concern with realism. What distinguishes the dependency perspective is that its proponents believe that this national interest can only be satisfied by addressing the needs of the poor within a society, rather than through the satisfaction of corporate or governmental needs. Trying to determine what is "best" for the poor is a difficult analytical problem over the long run. Dependency theorists have not yet articulated an operational definition of the national economic interest.
5. The diversion of resources over time (and one must remember that dependent relationships have persisted since the European expansion beginning in the fifteenth century) is maintained not only by the power of dominant states, but also through the power of elites in the dependent

states. Dependency theorists argue that these elites maintain a dependent relationship because their own private interests coincide with the interests of the dominant states. These elites are typically trained in the dominant states and share similar values and culture with the elites in dominant states. Thus, in a very real sense, a dependency relationship is a "voluntary" relationship. One need not argue that the elites in a dependent state are consciously betraying the interests of their poor; the elites sincerely believe that the key to economic development lies in following the prescriptions of liberal economic doctrine.

Frank contended that capitalism had long ago entered every nook and corner of the satellite (periphery) world in such a way as to make global capitalism an integrated structure of metropolises and satellite that bound different countries, regions and rural-urban areas into dominant-dependent relationships. A systematic transfer of economic surpluses continually occurred from the base of the world structure (periphery) to the metropolitan centres of the advanced countries. The peripheries (satellites) are nothing but the underdeveloped regions of the world which are integrated with the world capitalist system. This process developed the metropolises and harmed the satellites which became underdeveloped. In a macro world structure, the developed capitalist countries (DCs), can be regarded as the metropolitan centres and the less developed countries (LDCs) can be regarded as the periphery. However, looked at from the micro structure of a particular underdeveloped country, its centre can be regarded as metropolitan and its peripheries like different rural areas and regions can be called satellites. Just as in a macro sense, a metropolitan centre can exploit its peripheries representing underdeveloped countries as a whole, similarly, a particular underdeveloped country can also amass a large amount of economic surplus by exploiting its own peripheries. In both the cases, the idea is to accumulate surplus. This leads to a temporary development of the metropolitan centre (towns and cities) of an underdevelopment country but such a centre is exploited by the macro metropolitan centre of the capitalist world. Hence, the developed metropolitan centre of a backward country is again reduced to an underdeveloped centre. On the other hand, by drawing the surplus from the satellite, underdeveloped countries of the world, the DCs become more and more developed.

The contradictions of capitalism emerge in the course of historical evolution of capitalism. In capitalism, economic surplus is produced by many, but it is appropriated by only a few. Moreover, under capitalism, there takes place a polarisation of the capitalist system into metropolitan centre and the periphery. More often than not, the periphery is exploited and the surplus is accumulated for the development of the metropolitan centre.

Thus, firstly, the contradiction of capitalism manifests itself in a developed

metropolitan centre and also an underdeveloped periphery. As a result of the monopoly structure of capitalism, the surplus generated in LDCs passes into the hands of the metropolis. The surplus which remains in the periphery, is misutilised and is spent away on various types of unproductive activities and speculation. Secondly, as pointed out earlier, capitalism leads to a contradictory division of the world into two parts—one part (metropolitan centre) becomes developed and the other part (satellite or periphery) becomes underdeveloped. In other words, one part of the system develops at the cost of the other part. This is not only true of the macro-structure of capitalism, it is equally true of the micro-structure of a particular capitalist country where a city develops at the cost of rural areas and regions. The metropolis-satellite contradiction runs in a chainlike order throughout the entire capitalist world. It works from above to down below the system. In every case, the surplus from the weaker part is extracted and transmitted through a series of metropolis-satellite links.

Lastly, there is the contradiction of continuity in change. This implies that in spite of historical evolution of capitalism, its basic essential character has remained the same and the contradictions could not be eliminated. Frank has stressed the issue of continuity and similarity of dependency relations in the context of capitalism.

Frank points out that there is, in fact no national economies at all. There are simply national sectors of the world capitalist economy. The LDCs are incorporated into the capitalist structure of DCs in such a way that the former simply become a sector of the latter.

Frank opines that the DCs were never underdeveloped, though they have been undeveloped. Underdevelopment, according to Frank, is not a historical stage of growth through which the DCs passed, but rather, it is the result of the historical development of the capitalist system. So long as the LDCs remain as a part of the world capitalist system, their underdevelopment will be accentuated. Development and Underdevelopment, in a sense, are the opposite sides of the same system because they are the product of single but dialectically contradictory economic structure of capitalism. They are not produced by different economic structures or systems, or by different stages within the same system. One and the same historical process of development of world capitalism has simultaneously produced and will continue to produce both economic development and structural underdevelopment. The relationship between the metropolis and the periphery causes underdevelopment to the periphery. According to Frank, the relationship obstructs development and aggravates underdevelopment in a myriad of ways.

In the model of development advanced by Gunder Frank, we can see three important plans in his analysis.

- i. In the first plan, he shows that Latin American Countries have been inducted into the world economy since the early colonial era.
- ii. In the second plan, he shows that such countries have become capitalised economies by their incorporation into the world economic system.
- iii. In the third plan, he has demonstrated that there is a metro polis-satellite chain. Surplus is drawn away from the periphery by the centre, and as a result of that, the periphery is impoverished and the metropolitan centre is enriched.

Gunder Frank observes that a theory of underdevelopment should be able to "explain the causes and the phenomena which have brought about, and which maintain and generate the stagnation of Latin America and its distorted development". The analysis of underdevelopment, according to him, should be based on historical experience and realistic approach with reference to the Latin American countries. These countries were incorporated into the world capitalist system since long. Frank was pragmatic enough to point out that the same analysis which is applicable to Latin American countries must also be applicable to other LDCs. The problems of Latin American and other LDCs are similar in many respects, and they are essentially structural in nature which cannot be solved by the planning process or through foreign aid and assistance. Once the LDCs were integrated with the world capitalist system and started participating in the game of trade, their socio-economic and political structure were entirely distorted and they acquired the nature of a typical underdeveloped country having a typical export economy. Since these countries are integrated with the world capitalist system, the laws and contradictions of capitalism creep into these LDCs and they help the development of underdevelopment.

Gunder Frank maintains that underdevelopment is not something original or traditional and that neither the past nor the present of the underdeveloped countries resembles in any important respect the past of the now developed countries. Contemporary underdevelopment is mainly the historical product of past and continuing economic and other relations between the satellite underdeveloped and the now developed metropolitan countries. These relations are an essential part of the structure and development of the capitalist system on a world scale. It is a wrong notion that development of LDCs must and will be generated by diffusing capital, institutions and values to them from the DCs. On the contrary, in LDCs, economic development can occur only independently of most of the capitalist relationship.

The hypothesis that there is dual society in LDCs that, one modern and developed and the other traditional and underdeveloped, is a false hypothesis. It is not true to say that one part of the society is modern because of its relation with

the capitalist system and the other part is not modern because it is not related to the capital system. If such a hypothesis is acted upon, it will only perpetuate and intensify the very conditions of underdevelopment which LDCs have been trying to remove. Capitalism has entered even the most isolated sector of the underdeveloped world in the past centuries. Frank upholds that underdevelopment is not due to the survival of archaic institution and the existence of capital shortage in LDCs that have remained isolated. On the contrary, underdevelopment is generated by the same historical process which generated economic development, i.e. the development of capitalism itself.

Several hypotheses have been framed by Gunder Frank in connection with his thesis on development of underdevelopment.

- i. First hypothesis is that within the world-embracing metropolis-satellite structure, the metropolises tend to develop and satellites tend to underdeveloped.
- ii. Second hypothesis states that the satellites experience their greatest economic development if and when their ties to their metropolis are weakest.
- iii. Third hypothesis is that the regions which are the most underdeveloped and feudal-seeming today are the ones which had the closest ties to the metropolis in the past. This hypothesis contradicts the general belief that the source of a regions underdevelopment is its isolation from the capitalist world. Frank's
- iv. Fourth hypothesis is that, the greater the wealth that was available for exploitation in the past, the poorer and more underdeveloped" the region today; and the poorer the region was as a colony, the richer and more developed it is today.

The above hypotheses suggest that the global extension and unity of the capitalist system, its monopoly structure and uneven development throughout its history, and the resulting commercial rather than industrial capitalism in LDCs deserve much more attention than what they have received in the past.

Frank observes that the character and nature of change in a given society, are defined through the market relations. For Frank, the problem of the origins of capitalism comes down to the origins of the expanding world market and not to the emergence of a system of free wage labour. He developed a circular concept of capitalism in terms of its exchange relations. He has not given importance to the study of class relations in his analysis of development and underdevelopment. Frank has based his analysis on the premise that unequal market relationships within the capitalist economy and domestic economy produce development and underdevelopment on the international and national levels. Participation in trade with the capitalist world is responsible for the underdevelopment and a system which is producing output for the international, market is a capitalist system.

In LDCs, the export sector has been an important source of monopoly power. This sector is mainly controlled by the foreigners. The foreigners also control many other associated fields like transport, insurance and so on. And such controls ultimately dominate the political and military spheres of the domestic economy. Once involved in the dependency relationship, the LDCs became permanently incapable of moving out of the structure of dependence and underdevelopment. As a matter of fact, the pre-existing societies were entirely and completely transformed and became dependent on the capitalist system. In the process of underdevelopment of LDCs, the domestic bourgeoisie not only extracts surplus from the periphery, he is also interested in the continuance of foreign domination. But a time comes when the dependent bourgeoisie is no more capable of enhancing capitalist development. The important point made by Frank is that when capitalism is engulfing the whole world, it is not proper to consider any region or sector as feudal or capitalist. It is capitalism everywhere.

In the case of Latin America, the structure that emerged can be called colonial capitalism but not feudalism. The countryside was to some extent feudal but the cities were capitalist. Frank maintains that Brazilian agriculture was fully integrated into the capitalist system. The manifestations of capitalism are different in DCs and LDCs, but it does not imply that development caused by capitalism and, underdevelopment is caused by feudalism. Many people wrongly mistake metropolis-satellite polarization of the capitalist society and the monopoly concentration in LDCs as examples of feudalism. The existence of subsistence farming or family workshops and artisans does not indicate the existence of feudalism. According to Frank, the underdevelopment of agriculture is not due to the existence of feudalism but because of its complete integration with the world capitalist system.

Frank observes that with the passage of time, the structure of dependence has remained more or less the same but the basis of monopoly within the capitalist system has changed overtime. For instance, in the present century, the basis of metropolitan monopoly has more and more turned towards technology and its diffusion to LDCs. The LDCs cannot really innovate these technologies. They have to depend on the technology transfer from the DCs; but these imported technologies are not suitable to LDCs. The LDCs for no fault of their own, experience balance of payment deficits. Then, they have to take more foreign loans and assistance. Balance of payments deficit, resultant devaluation and increased money supply lead to inflation, which distort the whole situation in LDCs. In this way, the LDCs are involved in a trap of dependent structure. Very little capital is invested by the foreigners in domestic economies. Most of the capital is nothing but the profit earned from less developed countries. But the returns from these investments go to the metropolis.

In many ways, the surplus of the domestic economy is continuously drained out of the domestic economy in connivance with the national bourgeoisie. In a chain-like system of exploitation, the metropolitan centre of the advanced country exploits the national bourgeoisie who in turn also exploits the people of the domestic economy who are living in the periphery. Development at the core requires underdevelopment in the periphery. In such a system of dependence, the requirements of technology, finance, imports and things like that are determined by the metropolitan centre.

Frank maintains that the only alternative which is possible is that of breaking completely with the metropolis-satellite network through the socialist revolution. But the weakening of the satellite-metropolis network can only take place for reasons external to the satellite economies which may be transient in character. There is no real possibility of sustained development within the system. Another possibility is the withdrawal by the industrial capitalist countries from the LDCs. In any case, it is necessary to snap the ties and linkages with the metropolitan country. Dissolution of capitalism can be very helpful for the economic development of LDCs. A movement for the complete liberation of the backward country has to be started before any attempt is made for the economic development of the country.

He has shown that underdevelopment is not any inherent defect of a country. It is a product of colonialism. The capitalism existing in the peripheries did not evolve from feudalism or pre-capitalist mode of production. Capitalist mode of production was rather imposed from outside. Such a type of implanted capitalism did not help the development of satellite countries. On the other hand, it made them more dependent and backward. As a matter of fact, world capitalism has produced development and underdevelopment at the same time. Certain contradictions of capitalism are responsible for this type of situation. Capitalism has spread in LDCs and has created a chain of exploitative metropolis-satellite relationship which has worked in favour of DCs and against the LDCs. The stronger the metropolis-satellite relationship, the greater is the extent of underdevelopment in the satellite countries, and the weaker the relationship, the lesser is the extent of underdevelopment. Economic development has taken place only when the ties with the metropolis were temporarily weakened due to wars, depressions and other problems. The metropolis-satellite relations also exist between the relatively advanced capital city and the oppressed backward hinterland. These relations may be national or international. Nationally (from micro point of view), such relations can create sub-metropolis within a domestic economy which also has satellite rural and backward regions. Whether it is national or international, the relationship is meant for accumulating the surplus from the weaker national /international periphery. Frank has shown that the regions presently most underdeveloped \_ are those that were most tightly linked to the metropolis in the past.

The national bourgeoisie is helping the imperialist power to perpetuate domestic underdevelopment. This is very much observable in Latin American countries which have not yet been developed even after attaining political independence. The surplus from LDCs is still now being syphoned off to DCs through various ways and means devised by multinational corporations and international organisation. Once a country is integrated with the world capitalist system, there would be gradual development of underdevelopment. And the LDCs are forced to become the suppliers of raw material for the DCs. The process blocks the industrial development of primary producing countries. The export orientations and foreign dominance over these countries has limited the growth of their domestic market and the establishment of basic national industries for their own development.

### **The Policy Implications of Dependency Analysis**

If one accepts the analysis of dependency theory, then the questions of how poor economies develop become quite different from the traditional questions concerning comparative advantage, capital accumulation, and import/export strategies. Some of the most important new issues include:

1. The success of the advanced industrial economies does not serve as a model for the currently developing economies. When economic development became a focused area of study, the analytical strategy (and ideological preference) was quite clear: all nations need to emulate the patterns used by the rich countries. Indeed, in the 1950s and 1960s there was a paradigmatic consensus that growth strategies were universally applicable, a consensus best articulated by Walt Rostow in his book, *The Stages of Economic Growth*. Dependency theory suggests that the success of the richer countries was a highly contingent and specific episode in global economic history, one dominated by the highly exploitative colonial relationships of the European powers. A repeat of those relationships is not now highly likely for the poor countries of the world.
2. Dependency theory repudiates the central distributive mechanism of the neoclassical model, what is usually called "trickle-down" economics. The neoclassical model of economic growth pays relatively little attention to the question of distribution of wealth. Its primary concern is on efficient production and assumes that the market will allocate the rewards of efficient production in a rational and unbiased manner. This assumption may be valid for a well-integrated, economically fluid economy where people can quickly adjust to economic changes and where consumption patterns are not distorted by non-economic forces such as racial, ethnic, or gender bias. These conditions are not pervasive in the developing economies, and dependency theorists argue that economic activity is not easily disseminated in poor economies. For these structural reasons, dependency theorists argue that the market alone is not a sufficient distributive mechanism.

3. Since the market only rewards productivity, dependency theorists discount aggregate measures of economic growth such as the GDP or trade indices. Dependency theorists do not deny that economic activity occurs within a dependent state. They do make a very important distinction, however, between economic growth and economic development. For example, there is a greater concern within the dependency framework for whether the economic activity is actually benefitting the nation as a whole. Therefore, far greater attention is paid to indices such as life expectancy, literacy, infant mortality, education, and the like. Dependency theorists clearly emphasize social indicators far more than economic indicators.
4. Dependent states, therefore, should attempt to pursue policies of self-reliance. Contrary to the neo-classical models endorsed by the International Monetary Fund and the World Bank, greater integration into the global economy is not necessarily a good choice for poor countries. Often this policy perspective is viewed as an endorsement of a policy of autarky, and there have been some experiments with such a policy such as China's Great Leap Forward or Tanzania's policy of Ujamaa. The failures of these policies are clear, and the failures suggest that autarky is not a good choice. Rather a policy of self-reliance should be interpreted as endorsing a policy of controlled interactions with the world economy: poor countries should only endorse interactions on terms that promise to improve the social and economic welfare of the larger citizenry.

### **Critical Appraisal**

Frank's work has been subjected to severe criticism from various directions. In what follows, we will briefly discuss some of the crucial criticisms against Frank's thesis.

- i. Merely the existence or absence of a substantial market does not imply capitalism or feudalism respectively. Frank has not given emphasis on the production relations but has instead put emphasis on exchange relations. It is necessary to distinguish between capital in the sphere of exchange and capital in the sphere of production because the first does not automatically imply the second.
- ii. Frank has neglected the specificities of internal mode of production and class structure of the periphery and their impact. He wrongly makes market or trade as the determining factor in class formation. Frank did not attempt to integrate an internal class structure into his analysis of underdevelopment. However, it should be noted that development of underdevelopment is actually rooted in the class structure of production. Frank did deal with class in his later analysis but he only treated it as a phenomenon directly derived from the needs of profit maximisation, i.e. as determined by the market and in relation to the needs of national and international metropolis. Frank did not specify the particular historically developed class structure and did not take into

consideration labour productivity which is very crucial in any analysis of development and underdevelopment. It is also pointed out that Frank has ignored the role of state and its relations to class struggle and class alliances.

- iii. Frank has used the concept of capitalism in a sense which is erroneous from a Marxist point of view and which is useless for his central proposition that wants to demonstrate that a bourgeois revolution in the periphery is impossible.<sup>71</sup> In this connection, Laclau concludes that Frank has not made any new contribution. He has left the analysis where it was.
- iv. In Frank's analysis, there is an attempt to have a mechanical determination of internal structure by the external structure. This has dominated his idea to construct a model to explain the mechanism through which the expropriation of surplus takes place.
- v. Frank has not described the nature of the relations of dependence which keeps on changing along with changes in economic structures of DCs: the structures may be mercantilism, capitalism or imperialism. Each has its own nature of dependent relationship. According to Laclau, Frank's error follows from confusing the two concepts of capitalist mode of production and participating in world capitalist system. Frank thought that the colonial economies were capitalist, but within the system of world capitalism, they had a dependent and subordinate status. Frank could not satisfactorily define the distance between exchange and production relations, and confused between the integration of a given area into a world market dominated by capitalism and the local installation of the capitalist mode of production.
- vi. Frank's assertion that Latin America was capitalist from the time of the Conquest on, has given rise to a number of theoretical problems. Sternberg argues that Frank's assertion does not tally with Marx's historical analysis of the times.
- vii. Frank has observed that Latin American countries and other developing countries including India were capitalist in nature. Regarding India, it has been pointed out by critics that Indian agriculture was feudal rather than capitalist. The penetration of money and commerce is not necessarily an index of the growth of capitalist production relations. Simple exploitation of surplus does not mean capitalism as Frank thinks.
- viii. Feudalism is understood to be a closed or subsistence economy. Frank completely does away with the concept of production relations in his definitions of capitalism and feudalism. Frank is wrong in thinking that production for profit in the market is sufficient signal of capitalism and that trade relations are absent in feudalism. Frank's view that all peripheral countries are capitalists is not correct.
- ix. Frank has shown how advanced countries have exploited the peripheral countries, but he has not explained why certain nations needed the underdevelopment of other nations for their own process of expansion.

- x. Frank's theory of underdevelopment does not seem to be empirically correct. For instance, as Brown pointed out, India and Egypt have not been able to develop so well industrially as some other LDCs, in spite of their being politically independent. Moreover, industrial production has increased per head in many countries but agricultural production has stagnated. Industrial development in Asia, Africa and Latin America does not empirically support Frank's main thesis that there is a continuous flow of wealth from periphery to the metropolis.
- xi. According to some, when a backward country is integrated with a developed country, the productivity of labour in the former country must increase. However, this has not been the case in LDCs. This phenomenon cannot be explained by Frank's thesis.
- xii. Frank proposes a complete break with capitalism and a revolution for socialism. This contradicts the laws of motion of capitalism because in that case the revolution does not depend on the development of capitalism but it would be something unnatural imposition from outside. Moreover, socialism is not the panacea for all evils. Even under socialism, there may be all the demerits of capitalism, as the experience of many socialist countries shows.

However, in spite of the above points of criticism, it must be conceded that after Baran, the most elaborate work on dependency theory has been performed by Gunder Frank. The value of Frank's analysis lies in his magisterial critique of the supposedly dual structure of peripheral societies. Frank shows clearly that the different sectors of the economies in question are and have been since very early in their colonial history linked closely to the world economy. He has correctly brought out the fact that capitalist integration has not automatically brought about capitalist development in LDCs. Frank's direct contribution to the understanding of the process of Latin American development is limited to his critique of the dualistic model. However, there are considerable indirect contributions of Frank's analysis. In 1978, Frank incorporated into his analysis the issue of internal class structure, according to this, underdevelopment is the result of exploitation of the colonial and class structures. However, it is pointed out by Brenner that Frank has not been successful in his attempt in this direction. But all said and done, one needs to remember that Frank's work has inspired a significant quantity of research in many disciplines concerning development and underdevelopment, particularly in the sociology of development.

### **1.6.5 Summary**

Dependency theory is the notion that resources flow from a "periphery" of poor and underdeveloped states to a "core" of wealthy states, enriching the latter at the expense of the former. It is a central contention of dependency theory that poor states are impoverished and rich ones enriched by the way poor states are integrated into the "world system". Baran placed surplus extraction and capital

accumulation at the center of his analysis. Development depends on a population's producing more than it needs for bare subsistence (a surplus). Further, some of that surplus must be used for capital accumulation - the purchase of new means of production - if development is to occur; spending the surplus on things like luxury consumption does not produce development. After Baran, the most elaborate work on dependency theory has been performed by Gunder Frank. The value of Frank's analysis lies in his magisterial critique of the supposedly dual structure of peripheral societies. Frank shows clearly that the different sectors of the economies in question are and have been since very early in their colonial history linked closely to the world economy. He has correctly brought out the fact that capitalist integration has not automatically brought about capitalist development in LDCs.

### **1.6.6 Short answer type questions**

1. What is dependency theory?
2. Explain four fallacies in Baran's model.
3. Explain several hypotheses have been framed by Gunder Frank in connection with his thesis on development of underdevelopment.
4. What are the measures taken up by government to overcome economic backwardness?

### **1.6.7 Long answer type questions**

1. Critically evaluate Paul Baran's
2. Critically evaluate Andre Gunder's

### **1.6.8 Recommended Books**

|                   |   |   |
|-------------------|---|---|
| Michael P. Todaro | : | Economic Development in the Third World |
| Gerald M.Meier    | : | Leading Issues in Economic Development  |
| Chenery,H. And    | : |   |
| T.N.Srinivasan    | : | Handbook of Development Economics Vol.1 |

---

## Dependency Theory of Development–II Samir Amin

- 1.7.1 Introduction**
- 1.7.2 Objectives of lesson**
- 1.7.3 Global Accumulation and Maldevelopment**
- 1.7.4 Exposition of Samir Amin's Basic Thesis**
- 1.7.5 Summary**
- 1.7.6 Short answer type questions**
- 1.7.7 Long answer type questions**
- 1.7.8 Recommended Books**

### 1.7.1 Introduction

Samir Amin starts with the basic hypothesis that imperialism is compelled to spread capitalism on world scale. The crisis that occurred in world capitalism at the end of nineteenth century, mainly due to falling rate of profit and underconsumption, could be partially overcome by capitalist expansion in the peripheral countries (LDCs) of the world. Falling rate of return on capital at home compelled the capitalist world to search for new pastures in LDCs. From 1880 to World War II, monopoly capital was able to export capital. During the post-imperialism phase, after 1945, central capitalism organised itself to absorb surplus from the peripheral countries through militarism, capital export and unequal exchange. All these led to unleash imperialistic design on the part of the central capitalism. Amin defines this design as the perpetuation and expansion of capitalist relations abroad by force or without the spontaneous consent of the affected people. Amin observes that capitalism requires imperialism to counteract the adverse effects on profit maximisation. In the process of imposed extraverted accumulation, the peripheral economies find themselves distorted and disarticulated and in the midst of several modes of production. In such a case, the growth of capitalism is blocked and underdevelopment becomes a permanent feature.

Samir Amin's main thesis can be discussed with reference to his three main works: *Accumulation on a World Scale* (1974), *Unequal Development* (1976) and *Imperialism and Unequal Development* (1977).

### 1.7.2 Objectives of lesson

In this lesson we will discuss Amin's argument about the necessity of an analysis at the world level, his characterisation of peripheral economies and Amin's characterisation of economic relationship between centre and periphery.

### **1.7.3 Global Accumulation and Maldevelopment**

According to Amin, underdevelopment is not a lack of development. It is the reverse side of the development of the rich countries. The rich countries depend on the active exploitation of other countries, which renders the latter 'underdeveloped'. In works such as *Accumulation on a World Scale and Maldevelopment*, Amin argues against neo-classical economics from a class perspective. In common with other dependency theorists, he argues that the global economy systematically favours the continued enrichment of rich countries at the expense of poor countries. Throughout its history, capitalism constantly expands. Amin argues that mainstream economics simply theorises the management of capitalist expansion, and ignores the role of social conflicts in development. He argues that capitalist expansion starts at a certain place and time, but tends to expand globally.

Historically, it is divided into three phases. In the mercantilist phase (1500-1800), international exchange is created, partly through the looting of countries such as India and China. It is only after this looting that other parts of the world 'fall behind' European development. In the second, competitive phase (1800-1880), capitalism expanded through competition, based on the advantages it had already established. In the third and current stage (1880 to today), 'monopoly' capitalism, capitalism prevents declines in the rate of profit through the mechanism of unequal exchange.

Amin disagrees with Marx's view of crisis resulting from the declining rate of profit, which he thinks has been moved beyond today through the device of monopoly. The global model is monopolistic, establishing monopolies for the core countries on technology, control of financial flows, military power, ideological and media production, and access to natural resources.

Unequal exchange is the main means whereby capitalism reproduces inequalities. The rich countries create an international division of labour in which they subordinate and exploit other countries. Monopoly systems lead to 'super-profits', above the level which can be made in competitive markets. This means the beneficiaries of imperialism can't be out-competed in world markets. The global rankings are locked in place, despite 'free' market processes. Development in poor countries in this context tends to be a 'development of underdevelopment'. They undergo economic growth, but in ways which do not contribute to long-term development. Their surpluses are expropriated by rich countries, rather than used locally. Today, major means of surplus-extraction include structural adjustment and debt repayment.

### **1.7.4 Exposition of Samir Amin's Basic Thesis**

Samir Amin has studied the polarisation thesis in greater details. He has

analysed world capitalism in terms of two categories, namely, centre and periphery. These two concepts are related to the problem of expansion of capitalism in general. These concepts are essential for those who have a vision of capitalism which is neither western-centred nor economicist. Those who reject these concepts inevitably fall into the revisionist trap. In the discussion on analysis at the world level, Amin has pointed out many differences between centre and periphery.

The basic difference between centre and periphery is that capitalist relations in the centre are developed on the basis of the expansion of the home market, whereas these relations are introduced from outside in the case of periphery. In the centre, there is tendency of the capitalist mode of production to become exclusive. But it is not exclusive in the case of periphery. Another difference between centre and periphery is that in the centre, there is distinct polarisation of social classes into bourgeoisie and proletariat. On the other hand, at the periphery, since capitalism is introduced from outside, it is not exclusive, and at the same time, there is no perfect polarisation of classes. The social structure of the periphery is a truncated structure that can only be understood with reference to the world social structure. The structure in the periphery is truncated because it is dominated by the absentee metropolitan bourgeoisie. The centre, moreover, has higher labour productivity and wages. Wages and labour productivity are lower at the periphery. The nature of capital accumulation is also different between centre and periphery. In the centre, capitalism is characterised by autocentric accumulation, *i.e.* accumulation without external expansion of the system. Such a type of capital accumulation is not possible in the periphery. Since the peripheral economy exists only as an appendage of the central economy, peripheral society is, in a sense, incomplete. What is missing in such a society is the metropolitan bourgeoisie whose capital operates as the essential dominating force.

In explaining the necessity of world scale, in a macro-economic perspective, Amin has considered the distinctions between the centre and periphery. He further explains centre-periphery distinction by considering the fact that in an autocentric economy, there is an organic relation between the two terms of the social contradiction-bourgeoisie and proletariat. The autocentric economy is self-sufficient and independent, but peripheral economy is extraverted.

According to Amin, typologies of underdeveloped countries are superficial because- such typologies concentrate on appearances which mask the underlying unity of the phenomenon of underdevelopment. LDCs are a piece of single machine which is the capitalist world economy. This is the reason why it is impossible to have a perfect analysis of any one underdeveloped country in isolation from the world capitalist system. Such an analysis would emphasise simply appearances and would be misleading. The peripheral economies are

without any dynamism of their own; but the central economies have internal dynamism. Amin observes that there are various forces which will propel the world system. As a matter of fact, the theory of underdevelopment and development is a theory of accumulation of capital on a world scale. In his book, *accumulation on a World Scale*, the dynamics of the system has been explained by a single tendency: the tendency of the rate of profit to fall remains the essential and permanent expression of the basic contradiction of the system. However, later on, Amin has explained the dynamics in terms of the inherent tendency of the capitalist mode of production to raise the surplus value and the search for higher profits, without relating them to the trend in the rate of profit.

#### Distinction between Central Capitalism and Peripheral Capitalism

| <b>Central Capitalism</b>  | <b>Peripheral Capitalism</b>  |
|--|---|
| Capitalist relations develop on the basis of expansion of home market. | Capitalist relations are imposed from outside.                                |
| Pure capitalist mode of production exists.                             | Pre-capitalist mode of production exists.                                     |
| Autocentric accumulation is present. Accumulation is voluntary.        | Autocentric accumulation is absent. Accumulation is extraverted or distorted. |
| Economy has an independent and complete existence.                     | Economy is an appendage-truncated part of the centre.                         |
| There is complete society.   | The society is incomplete.  |
| Polarisation of classes: bourgeoisie and Proletariat.                  | No polarisation of classes.   |
| There is internal dynamics.  | There is no internal dynamics.  |
| Capitalism is exclusive.   | Capitalism is not exclusive.  |
| Wage level is high.  | Wage level is low.'   |
| Development is articulated.  | Development is disarticulated (distorted).                                    |

According to Samir Amin, all peripheral or satellite countries have the following four main characteristics:

- (i) the predominance of agrarian capitalism,
- (ii) a local, mainly merchant, bourgeoisie that is dominated by foreign capital,
- (iii) the growth of large bureaucracy, which substitutes for the leadership of an urban bourgeoisie,- and
- (iv) incomplete polarisation, which takes the form of masses of poor peasants, urban unemployed people and many marginal workers, who have not developed completely into a proletarian class.

As a result, the peripheral countries have experienced extraverted form of development of local capitalism. These countries cannot achieve development of their own momentum, but are reduced to an incomplete and extraverted development of local capitalism. Moreover, the central capitalism also imposes an unequal exchange between it and the periphery in which the periphery is exploited through trade. Amin observes that peripheral countries experience extreme unevenness of development, disarticulation of the economy and a development process that is not cumulative. The dominance of foreign capital over the periphery means distorted type of development. The periphery, in order to develop itself and eliminate distortions, incur huge amount of debt from the central-capitalism, and in this way, the periphery ultimately finds itself in the debt trap.

The peripheral capitalist mode of production has the dual feature of a modern technology and low wages within the framework of the capitalist social organisation. The productivity cannot be very high in the peripheral countries. The labour is cheap, but its productivity is also low. The peripheral countries are characterised by the pre-capitalist mode of production.

The differences existing between central capitalism and peripheral capitalism have been called *distortions* by Amin. Capitalism in the peripheral is imposed from outside, and the distortions are mainly caused by the introduction of foreign capital. Peripheral capitalism is characterised by the following three kinds of distortions:

- (i) There is distortion towards export activities (extraversion).
- (ii) There is abnormal enlargement (hypertrophy) of the tertiary sector,
- (iii) There is distortion towards light branches of activity (light industries) and the use of modern production technique.

The hypertrophy of the tertiary sector reflects the difficulties of realising surplus value at the centre and limitations of peripheral development—high rate of unemployment and inadequate industrialisation. The second type of distortion (hypertrophy) is expressed in excessive rise in government expenditure and a crisis in public finance. The development policies in the periphery are different from those in the centre. According to Amin, underdevelopment is not manifested in particular levels of per capita production, but in certain special structural features. There are many such structural features of underdevelopment in peripheral countries. Some of these features are : extreme unevenness in the distribution of income and in the system of prices transmitted from the centre, disarticulation and economic domination by the centre. Amin observes that as economic growth proceeds, the features of underdevelopment are accentuated. In the peripheral countries, whatever is the rate of growth of income achieved, autocentric growth becomes impossible.

Some of the peripheral countries (Hong Kong, Taiwan and so on) which have achieved some industrial growth and are now exporting finished products are simply showing a new form of inequality. Most of the LDCs still suffer from balance of payments problem and none has been able to achieve self-sustained economic growth. In such countries, there is still the domination of the central capitalism which prevents the formation of a national bourgeoisie. Only a middle class develops with the consumption pattern and ideology of the world system.

In the peripheral countries, economic growth is blocked because such countries are dominated by the centre. LDCs are prevented from accumulating capital because such capital is sent away from the peripheral countries. Since there is domination by the centre, the development of underdevelopment is neither regular nor cumulative. Development in such countries is somewhat jerky and discontinuous. All these are manifested in a *double crisis* of external payments and of public finance. Such a crisis is inevitable and frequent in LDCs. With economic growth, none of the bad features of LDCs is weakened, rather these features are accentuated.

Having discussed the features of peripheral economies, as above, we can now elaborate Amin's characterisation of the economic relations between centre and peripheral countries. This has been discussed in his book, *Imperialism and Unequal Development*. In this discussion, Amin has mainly concentrated on the problem of unequal exchange as discussed by Arghiri Emmanuel. Amin has not accepted many points of view of Emmanuel. Amin says that two aspects of the theory of unequal exchange can be said to be essential. The first is the pre-eminence of *world values* and the second is the universal character of capitalist commodity alienation based on the direct or indirect sale of labour power. While in a capitalist system, the rate of profit is equalised, the remuneration of labour varies from country to country because labour is immobile. The transformation of international values into international prices implies the transfer of value from some nations to others. Since all products are international commodities, the same quantity of labour used up in different parts of the world will also give rise to a single world value. It is clear that if the labour-hour in all countries creates the same value, while the labour power in one of the countries has a lower value (lower real wages), the rate of surplus value is necessarily higher. Amin finds that surplus value generation is generally higher in LDCs.

Amin is of the opinion that the real case of unequal exchange will be present when the rates of surplus value are different in different countries, and the transfer of values takes place not as a result of different organic compositions of capital, but because of the immobility of labour. In fact, the immobility of labour is responsible for the variation in real wages in different countries. Amin observes

that in the periphery, the pre-eminence of world values may be overshadowed by the appearance of non-capitalist modes of production. But in reality, direct producers are dominated by capital. The pre-eminence of world values constitutes the essence of the unity of the world system. If the world system were regarded merely as a juxtaposition of autonomous national systems, then international trade could not be analysed objectively-through the analysis of the law of value.

Unequal exchange is internally accompanied by unequal internal exchange at the periphery. Amin observes that such a behaviour will reproduce the system, if low wages are maintained despite modern technology. Thus, proletarianisation must be slowed down and precapitalist mode of production must be exploited. According to Amin, the distortions of peripheral capitalism do involve a problem of surplus absorption. However, this is solved by means of transfer of surplus and capital to the centre and also through the consumption of luxury goods in the periphery. Such a type of consumption is permitted by the import of foreign technology and culture and also by the development of protected import-substituting industries. But in any case, broadly, the dependent system is reproduced. The bourgeoisie stops being a national entity. It does not satisfy the historical function of primitive capital accumulation. It always tries to protect the precapitalist mode of production to dominate the peripheral country. It also tries to make wasteful expenditure and absorb the surplus value through the consumption of luxury goods. Amin rightly asserts that dependency, is not imposed but is necessary to generate the surplus in the peripheral countries.

Amin asserts that international specialisation started when capitalism became a world system, and this was the result of Industrial Revolution. However, a peripheral situation is not related to the specialisation in the export of certain products, because the kind of products exchange has evolved, and therefore, the initial form of specialisation has significantly changed. But in spite of all these, the situation in the periphery has remained more or less the same, due to discrepancy in the wage level. The impact of specialisation on the periphery has essentially remained the same. It has led to a number of *distortions* which have blocked the road for development. Amin is of the opinion that inequality in wages, due to historical reasons, constitutes the basis of a specialisation and a system of international prices that perpetuate this inequality.

Inequality in the wage level can explain both primitive accumulation as well as International specialisation. In Amin's analysis, the existence of *autocentric accumulation* characterises the central capitalism, and its absence characterises the periphery. Autocentric accumulation means accumulation without external expansion of the system. Such an accumulation is possible theoretically if real wages increase at a given calculable rate. In the periphery, the principal articulation is completely absent. According to Amin, low wages in the periphery

lead to a deficiency in demand as a result of which mass consumer goods industry is not sufficiently developed. This implies a distortion in the economy and a lack of self-reliance. The reason for the low level of wages in the periphery is mainly due the fact that capitalism is not exclusively present in the 'periphery.

Amin has shown a typology of underdevelopment in which he describes three factors which account for the diversity of peripheral economies. These factors are:

- (i) the structure of the precapitalist formation at the moment of its integration into the world market;
- (ii) the economic forms of international contact; and
- (iii) the political forms which accompanied the integration.

These factors have led many economists to deny the unity of phenomenon of underdevelopment because these factors produce diversity of the real models of underdevelopment. Many economists consider that there are only underdeveloped economies but not underdevelopment. However, according to Amin, the latter is nevertheless a fact. Amin asserts that the unity of the phenomenon of underdevelopment lies in the peripheral character that is common to all LDCs in relation to capitalism and not in the mere appearances. Amin claims that the diversity among LDCs is superficial, disguising the essential unity. However, Amin's work is mainly a work on the periphery and its relations with the centre. He thinks that in LDCs, the sectors are merely juxtaposed and are not properly integrated. Thus, the analysis of national economies is meaningless because such economies cannot be properly understood except at the world level.

We are now in a position to summarise the essential points of Samir Amin's main thesis on unequal development. Amin points out that central capitalism enters into the peripheral countries and creates-mainly three types of distortions. *Firstly*, it gives a more attention to export activities and extra-version of the economy. The export activities dislocate the internal production structure. *Secondly*, the entry of central capitalism into the periphery changes the technique of production in such a way that light industries are encouraged and technology transfer by the central capitalism goes on rampantly. This creates some sort of technological dependence. *Thirdly*, the entry of central capitalism into the periphery also distorts the tertiary sector in such a way that it becomes disproportionately larger as compared to the other sectors of the economy. As, a result, many people in this sector are absorbed with low level of productivity and income. In other words, tertiary sector becomes the abode of low productivity, low income and disguised unemployment and underemployment.

In order to eliminate these distortions, and also for launching development programmes, the LDCs incur huge debts from the centre, and they also

participate in the unequal exchange with the centre. Because of these two main operations, sufficient amount of surplus is taken away from the LDCs. The surplus is transferred to DCs. The inevitable result is the underdevelopment of the periphery. And once the periphery is put to the morass of underdevelopment, it once again becomes dependent on the central capitalism, and this process continues.

It is true that so long as the dogma of the periphery's integration into the world market is not challenged, the periphery is without economic means of action in relation to the multinational corporation's monopolies. Amin asserts that there is no point in developing forms of financial control. In fact, the creation of a national currency confers on the local authorities no power in reality of effective control as long as the country is included and integrated with the world market, and its position *vis-a-vis* the position of world capitalism is not challenged. LDCs are prone to have all the business fluctuations of the developed capitalist countries. The fluctuations in the value of the currencies of DCs will ultimately affect the LDCs. In the same way, the price structure of DCs is easily transmitted to the LDCs. This assertion is true as we find in modern times that the inflation of "developed countries is exported to the poor developing countries. In the context of the world economy, money becomes the outward form of an essential relation of dominance. Under these circumstances, Amin aptly says that economic policy at the national level in a peripheral capitalist economy is largely ineffective.

As economic growth in the periphery proceeds, so also develops underdevelopment. Amin opines that autonomous and self-sustained growth is impossible in LDCs irrespective of the level of per capita output. Since no development is possible, it is necessary to have a complete break with the world capitalist system. This will provide the necessary condition for the genuine development. According to Amin, development is hampered by the outflow of surplus from the periphery. If some steps are taken, economic growth may occur but not economic development because development is structural in nature, which cannot be so easily changed. Development is possible when tie with the central capitalism is snapped. Some sort of delinking is required from the centre for the development of productive forces. Amin observes that socialism is necessary because it is a means to achieve autocentric accumulation.

### **Critical Appraisal**

Samir Amin's analysis is full of useful information and ideas about the nature of peripheral economy and the causes of its underdevelopment.

- (i) Charles Barone reproves Amin for his excessive eclecticism. Barone says that Arnin's thesis that capitalism has undergone profound transformations over the years changing the essential character of capitalism is not true. Moreover, his analysis of capitalism is based on exchange relations and not

- on production relations.
- (ii) Barone has pointed out that Amin's dependency analysis is superficial surface analysis. He fails to properly analyse the mode of production in LDCs.
  - (iii) Amin fails to integrate his analysis with the formation of class structures and the changing nature of accumulation process.
  - (iv) Amin has a unitary vision of development, to him, development is a purely and only a centre-determined process. This unitary vision is a historical and fails to take account of the historical specificities Third World experience.
  - (v) There is a contradiction in Amin's analysis. Bernstein observes that the concept of autocentric accumulation necessarily rules out the concept of world system, but Amin had both these concepts in his theory. Capital accumulation in the core, as is well-known, depends on the peripheral exploitation. In such a context, it does not sound very logical to speak about autocentric accumulation. Metropolitan capitalism in Amin's theory requires periphery.
  - (vi) If the basis of unequal exchange is the wage differentials, then there can be unequal exchanges between many DCs because there are wage differentials between them. It is not clear how it can be an exclusive characteristic of trade between the centre and periphery alone.
  - (vii) There seems to be a contradiction in Amin's analysis of unequal exchange. Theoretically, for unequal exchange to be valid, wage differentials must be greater than productivity differentials. Amin says that high wages in the centre are due to mainly high level of development of productivity forces (productivity). Thus, productivity of the centre may be several times greater than the productivity in the periphery. If it is true, then it contradicts the basis of unequal exchange.
  - (viii) Amin says that national economies do not have the power to manoeuvre and that their economic policies are ineffective. These observations are not really correct. Manoeuvrability depends on the degree of dependence and the nature of the domestic state. A highly progressive state can very well formulate and implement economic policies. This is true of many LDCs of our times.
  - (ix) Amin's suggestion of decentralisation and nationalisation of capital is against the laws of development of human society and is Utopian.
  - (x) As Amin wrongly suggests, breaking away with the central capitalism may have dangerous consequences, as in the case of Kampuchea. It is neither possible nor desirable for all types of LDCs. Amin has called LDCs as capitalist, although merchant/commercial capitalism pre-dominates there, and precapitalist structures are not destroyed but simply reinforced.

However, in spite of the above points of criticism, Amin's analytical umbrella seems to be much wider and it includes the analysis of the impacts of

imperialism, unequal exchange and central capitalism on the underdevelopment of LDCs.

### **1.7.5 Summary**

Amin points out that central capitalism enters into the peripheral countries and creates mainly three types of distortions. It gives more attention to export activities and extra-version of the economy. The export activities dislocate the internal production structure. The entry of central capitalism into the periphery changes the technique of production in such a way that light industries are encouraged and technology transfer by the central capitalism goes on rampantly. This creates some sort of technological dependence. The entry of central capitalism into the periphery also distorts the tertiary sector in such a way that it becomes disproportionately larger as compared to the other sectors of the economy. As a result, many people in this sector are absorbed with low level of productivity and income. In other words, tertiary sector becomes the abode of low productivity, low income and disguised unemployment and underemployment.

### **1.7.6 Short answer type questions**

1. What are distinctions between Central Capitalism and Peripheral Capitalism?
2. Explain the distortions in Amin's model.
3. What is autocentric accumulation?
4. What is unequal exchange?

### **1.7.7 Long answer type questions**

1. Critically evaluate Samir Amin's model of unequal exchange.
2. Explain the main points of Samir Amin's model of unequal development.

### **1.7.8 Recommended Books**

|                   |   |  |
|-------------------|---|--|
| Michael P. Todaro | : | Economic Development in the Third World  |
| Gerald M. Meier   | : | Leading Issues in Economic Development   |
| Chenery, H. And   | : |  |
| T.N. Srinivasan   | : | Handbook of Development Economics Vol. 1 |