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ALTERNATIVE APPROACHES TO DEVELOPMENT ECONOMICS: AN EVALUATION

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Abstract

We discuss three alternative approaches to development economics, neoclassical, Marxist, and structural-institutionalist. Focusing on five selective areas of enquiry, (a) theory of the household, (b) institutions and resource allocation, (c) income distribution and growth, (d) trade and development and (e) economic policy and the state, we try to show that the differences between sophisticated versions of alternative approaches are narrower than are generally perceived.

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ALTERNATIVE APPROACHES TO DEVELOPMENT ECONOMICS: AN EVALUATION

by

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Alternative Approaches to Development Economics: An Evaluation*

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Pranab Bardhan

1. Introduction

Development economics as a separate branch of economics originated in a widespread perception of the limited usefulness of orthodox economics, and even though its pristine separatism has mellowed over the years it retains to this day its contrary, unruly, if somewhat flaky, image in the eyes of mainstream economists. Standard neoclassical economics is mainly on the defensive in this terrain and a number of alternative approaches clash and contend for our attention. In my subsequent discussion I shall primarily deal with three major approaches, what can be classified somewhat loosely as neoclassical, Marxist and structuralist-institutionalist. These are, of course, portmanteau categories, each containing widely diverse strands of methodology and analytical assumptions and results. There is, for example, a world of difference between Marxists who believe in methodological individualism and other Marxists, just as there is between the neoclassicals in the Walras-Debreu tradition and those of the Akerlof-Stiglitz vintage. Yet they are usually clubbed together in an undifferentiated group by their adversaries: larger targets make shooting practice easier. What is more, with the lines of mutual communication

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* I am grateful for comments on an earlier draft by Clive Bell, Hollis Chenery, David Evans, Steve Marglin, Alan Richards, T.N. Srinivasan and Suresh Tendulkar. The remaining blemishes are no doubt due to my laxity in following up on all of their suggestions.

between contending schools largely blocked by years of misunderstanding and jargon-mongering, easy 'victories' are often unilaterally claimed and hailed after setting up essentially a straw man to represent the opposing viewpoint and comfortably shooting it down. I happen to believe that the differences between the more sophisticated versions of alternative approaches, even though substantial, are narrower than are generally perceived.

In this paper I shall not attempt a comprehensive examination of all aspects of the alternative approaches. Instead I shall focus on a few, highly selective, areas of enquiry with a brief, impressionistic, comparative assessment of some major contributions in each area. The following five sections deal with five such distinct but not entirely unrelated areas: (a) theory of the household; (b) institutions and resource allocation; (c) income distribution and growth; (d) trade and development; and (e) economic policy and the state. While these five certainly do not exhaust the arenas of conflict among the different approaches, they in my judgment involve some of the core issues of development economics and may represent a fair cross-section of some of the active disputes. I should also note that for considerations of space as well as personal competence I have excluded a discussion of short-run macroeconomic issues: for example, some of the major policy disputes relating particularly to Latin America between structuralists and monetarists will remain entirely unrepresented in this paper.

constraints. Even patron-client relations, which are often cited as a mark of a traditional custom-bound social system or a 'moral' economy, may sometimes be viewed as a form of rational response to a situation of desperate need of subsistence insurance and protection on the part of the client, and that of ready availability of cheap labour services for the patron. It may also be quite rational for a landlord or an industrial monopolist to 'waste' some resources in activities and rituals enhancing his social status or political power, which (in terms of current industrial organization theory) may often be regarded as investment in entry barriers to particular markets. The presumption of rationality, in this extended sense, may thus be a good starting hypothesis to work with, even if one ends up by finding it to be violated in many particular cases.[1] As Elster (1979) comments: "This presumption is a 'principle of charity' similar to the one often used in textual interpretation. One should never take textual contradictions at their face value, but consider whether the context might not give a clue to consistency. Similarly, one should always look very closely at apparently irrational behaviour to see whether there could not be some pattern there after all." Development economics is full of examples of how apparently irrational behaviour may be successfully explained as an outcome of more complex exercises in rationality,

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[1]There are, of course, many cases of <u>systematic</u> cognitive errors like the ones analyzed in the work of Tversky and Kahneman (1986). In a world of incomplete information it is also difficult to distinguish between irrational and uninformed behaviour. One should also keep in mind that while the neoclassical maximand is usually income or utility, the objective of self-realization is more central to Marxism: thus work, which invariably yields disutility in neoclassical models, may be a channel for self-realization under appropriate organizational conditions. Sometimes self-esteem, following certain culturally specific codes of honour, is more important to the individual than the usual neoclassical maximands.

2. Theory of the Household

2.1. Maximization, even by peasant households in traditional agriculture, is a basic presumption in neoclassical development economics. Marxists, on the other hand, often emphasize the overwhelming importance of structural constraints, leaving little scope for freedom of action or rational choice. As Elster (1979), a 'rational-choice' Marxist, comments, clearly they mean this to apply with some asymmetry, members of ruling classes, for example, supposedly having more choice and less hemmed in by structural constraints than the subordinate classes. And in their choice, even if not all members of the former classes are maximizers, the competitive process will tend to weed out the non-maximizers. This biological model of the survival of profit-maximizers is, for example, implicit in the Marxian assumption of equality of profit rates through competition of capital. But when competition is lacking, when markets are 'thin' or highly segmented or inadequately formed, non-maximizers (like large landowners wastefully using their land) can survive for a prolonged period. The plausibility of the assumption of maximization is thus not entirely independent of the market structure or even the mode of production.

A large empirical literature has now accumulated confirming intimations of peasant rationality, particularly when one is careful to take into account the insurance motivation under the pervasive uncertainty in the physical and social environment. In the neoclassical empirical literature rationality has often been interpreted in the very narrow sense of price responsiveness. But even when a farmer is not very sensitive to market prices or the markets themselves are inadequately formed, there may still be ample evidence of a coherent pattern in his behaviour which indicates his attempt, by and large, to improve his condition under the given constraints of norms or duty. Not merely intra-family allocation of work and goods, but complex institutions like marriage or extended family, are sought to be explained in this way. To analyze family relationships as if they are market transactions at implicit prices, with the focus on income and substitution effect of price changes on these relationships, is to ignore the complex of institutions on which contracts in actual markets crucially depend and to oversimplify the mix of cooperative and conflicting elements in family relations. The Marxist literature, since the appearance of Engels' The Origin of Family, Private Property and the State in 1884, has also been full of simplistic and economic-reductionist generalizations on family relations, but usually they are somewhat more sensitive to historical and institutional variations across different modes of production. I should also note here that Marxists (or anyone else for that matter) have not been able to provide a satisfactory explanation of why rules of family formation and inter-generational property transfer ("modes of reproduction") have sometimes been extraordinarily persistent over several centuries of changes in forces of production. Primogeniture, for example, gained wide acceptance in Europe with the spread of feudalism, but it has long outlived feudalism and helped capitalist accumulation.

2.3. There are elegant neoclassical models of agricultural households taking inter-dependent decisions on production, consumption and labour supply.[2] One of the striking results in this literature is the separability of the consumption and production decisions. For example, in these models farm labour and other input demands can be solved as functions of

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[2]For a good survey, see Singh, Squire and Strauss (1986), ch.2.

particularly with deeper probes into the nature of the feasibility constraints or the preference patterns.

At the same time the rigid maximization in the formal neoclassical models clearly ignores the manifold ambiguities of interest perception among individual agents in the real world particularly in situations of poverty and deprivation. Marxists in this context have emphasized (though not analyzed at sufficient depth) the social determination of preference patterns and the role of ideology in legitimizing existing systems of exploitation. The poor often internalize the severe constraints they face (and their earlier generations have faced) and its expressions may take the form of fatalism, low aspirations, low perception of needs, high rate of time discount and so on. And as Sen (1984) reminds us, "many of the inequities of the world survive by making allies out of the deprived and the abused."

2.2. Most rational-choice Marxists as well as neoclassical economists take the household as a compact decision-making unit and, until recently, have underemphasized intra-household conflicts of interest, particularly among members in different age-sex categories. Household behaviour in response to changing prices and income may not, for example, be easily explained if the same changes affect the relative bargaining power (or fall-back options) of different household members in different ways. Similarly, the expansion of market may expand the choices for some members of the family while limiting them for others. This has important implications for the impact of the development process particularly on the conditions of women.

One variant of the neoclassical household economics, following Becker (1981), treats the family as composed of what Sen (1984) calls 'super-traders' relentlessly pursuing their individual utilities without in secondary and tertiary sectors, writers like Boserup (1965) have pointed to many cases of improvement in traditional agricultural practices on peasant farms induced by population growth (Marxists usually ignore such effects of demography on the development of the forces of production) and Geertz (1963) has pointed to the related demographic-ecological processes of 'agricultural involution' providing a surprising elasticity to the system. While orthodox Marxists usually associate capitalist agriculture with large-scale capital-intensive methods of production, more recent advances in bio-chemical technology associated with the so-called green revolution have shown possibilities of successful adoption on small farms. The main constraint here is not the small-scale nature of production as such but more the availability of public infra-structural facilities like irrigation, power, extension services, and credit and the acute problem of externalities generated by a crazy quilt of petty private property rights, underlining the need for community cooperation in land consolidation, water allocation, soil conservation and so on. In parts of East Asia (Japan, Taiwan, etc.) where the public infrastructure, cooperative organizations and communal rules have provided these services, small-scale labour-intensive peasant farms have thrived for a long time. In densely populated countries the Japanese road to agricultural development may be a historical alternative to Lenin's oft-quoted 'Prussian' or 'American' roads.

In the more recent Marxist literature on what de Janvry (1981) calls 'functional dualism,' it is claimed that the coexistence of peasant farms is functional to the on-going process of agricultural and industrial capitalism since the former lower the wage costs to the capitalists. I am not sure I quite understand this argument. It appears to me that the wage costs for the capitalists may be even lower if the peasant farms are wiped market prices, technological parameters of the production function and factor endowments, and consumption depends on market prices and full income. Preferences, prices of consumer goods and income do not affect production decisions. This separability property makes econometric estimation easier, since all prices can be taken as exogenous to the household.

But the separability result crucially depends on the assumption of perfect markets. If some markets are non-existent or incomplete or imperfect, as is often the case in developing countries, the household may be constrained to equate consumption with own production for some commodities. These constraints will be associated with a set of shadow prices (in general different from market prices) which will depend on the household's endowments, technology and preferences. Output supplies, production techniques and input demands will thus depend on household preferences and endowments through these shadow prices. The imperfect marketability of labour, for example, leads to the differential labour intensity in different size classes of farms, as is often emphasized in the literature on size and productivity. There are also other important (e.g., dynamic) ways in which the household consumption and production decisions may interact which the standard static models do not capture.

2.4. The peasant household in the orthodox Marxist literature belongs to what Shanin has called an 'awkward class.' Both Lenin and Rosa Luxemburg pointed to the tenacity of peasant survival delaying capitalist take-over in European agriculture. In the much more densely populated agriculture of Asia, this delay has often been prolonged enough to raise doubts about the transitional nature of the mode of peasant proprietorship. While Marxists often see in this tenacity peasants' astonishing capacity to take punishment or 'self-exploitation,' always adjusting to the labour absorption rate rational-choice Marxists of the methodological necessity of tracing the microfoundations of class analysis in postulates of individual behaviour.[4]

Neoclassical economics with its traditional preoccupation with competitive equilibrium, of course, avoids the key Marxian concept of class struggle as a mechanism of historical change. Nevertheless, the recent advances in the application of bargaining theory in neoclassical microeconomics may be fruitfully used in the analysis of class struggle, just as the literature on collective action gives us some clues in studying what blocks class formation particularly among the poor.

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[4]One common criticism of such methodological individualism is its alleged oversight of the fact that individual actions are sometimes derived from supra-individual entities (like a kinship group, caste, community, nation, etc.). But the doctrine of methodological individualism does not preclude such substantive facts of individual human nature. It only gives explanatory priority to individuals and claims, to quote Elster (1985) again, "that all social phenomena--their structure and their change--are in principle explicable in ways that only involve individuals--their properties, their goals, their beliefs and their actions." These need not be individualistic individuals.

out and the erstwhile self-employed peasants now crowd the wage labour market (unless one introduces high supervision costs that the employers have to incur).

2.5. In the theory of peasant households while Chayanov emphasizes demographic differentiation among the peasantry (on the basis of variations in resource balance over the family life-cycle), and classical models like that of Arthur Lewis focuses only on family farmers in agriculture, Marxists give much more importance to class differentiation. Roemer (1982) has provided an endogenous determination of class structure on the basis of differential ownership of means of production.[3] Extending his model to introduce the limited access of agents to working capital and the requirement, necessitated by moral hazard, that the supervisor of the farming activity be the residual claimant of output, Eswaran and Kotwal (1986) have developed a model where four agrarian classes (labourer-cultivators, self-cultivators, small and large capitalists) emerge as a result of the utility-maximizing activities of individual agents bound by time (strictly, imperfect substitutability between own time and unsupervised hired labour) and capital constraints. Class hierarchy, and the attendant misallocation of resources (with land-to-labour ratios differing across farm sizes), are thus the direct outcome of imperfections in labour and capital markets. This is a good example of how Marxist results can be derived rigorously with neoclassical methods. There is a growing recognition among

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[3]For an application of Roemer classification scheme and a discussion of its limitations in the context of Indian agriculture, see Bardhan (1984), Ch. 13.

often because prerequisites for such improvements involve massive public investment in irrigation and flood-control, research and extension and the privately inappropriable externalities they generate. In areas or crops where high-yielding (and disease-resistant) seeds are available, along with a public network of irrigation and drainage, the merchant-moneylender resistance to adoption of innovation has not been significant and even rentier landlords have often converted themselves, in the style of later Prussian junkers, into enterprising farmers.[6]

Even when economic betterment following from adoption of innovations is to increase the general bargaining power of agricultural workers or reduce the political control of landlords over them, in an environment of competition no individual landlord will be rationally deterred from such adoption.[7] But in a situation of market segmentation and territorial monopoly, a local landlord can get away with delaying adoption. (Even when there are a few local landlords the theory of repeated games shows how collusive arrangements may be attained even in non-cooperative situations). Similarly, it is not enough to point out that land-saving bio-chemical

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[6]In this context I do not find Bhaduri's (1983) predator-prey model (with antagonistic relationship between merchant-moneylender class and the class of rich farmers) very plausible, either on theoretical or empirical grounds. Theoretically, he has not shown why and how entry from one of these classes to the other is restricted; empirically, he ignores the substantial evidence of portfolio diversification of the rural rich in farming, lending, trading and other businesses and services, nor does he cite any evidence that in recent years productive investment by rich farmers has been resisted by professional moneylenders or traders.

[7]Braverman and Stiglitz (1986) have drawn attention to some special cases where a productivity-raising innovation may be resisted by an individual landlord if such an innovation at the same time accentuates the incentive problems. See also the discussion on interlinking and innovation by Clive Bell in chapter 17 in this volume.

3. Institutions and Resource Allocation

3.1. A persistent theme in Marxist and other institutionalist writings in development economics is how certain institutions or production relations act as 'fetters' on the development of forces of production. The most frequent examples here are drawn from the retarding effects of agrarian institutions in many poor countries, like the elaborate hierarchy of rent-extracting land rights, sharecropping, usury, speculative trading and so on.[5] The nature of these effects, however, needs to be clearly spelled out. It is easy to see that the direct cultivator, squeezed by layers of landlords in the subinfeudation process, has limited incentive to fully utilize or develop the forces of production. But the primary question is why the landlord does not use his surplus in productive accumulation. To answer this by showing that the rate of return to rentier activities or usury or speculation is high is somewhat circular; one still has to show (a) why the rate return to productive investment is low, and (b) why and particularly how yield-increasing innovations, potentially raising the latter rate of return, will be blocked by the unproductive landlord, money-lender or trader interests. In large parts of the world where some of the poorest people live (for example in regions of monsoon paddy or unirrigated dryland cultivation) the basic technology has remained extremely backward and ecologically fragile, not always because easily available technological improvements have been undercut by vested interests, but

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[5]In pre-capitalist economies there is also a tendency, as Brenner (1985) puts it, of the dominant class to invest in the development of the means of coercion at the expense of developing the means of production. But as the level of available production technology improves, the relative rate of return from investment in coercion should drop.

example, in the neo-neoclassical economics of (imperfect) information.[8] The terms and conditions of (implicit or explicit) contracts in various transactions critically depend on the distribution of assets and the former have important effect on the efficiency of resource allocation. The inefficiencies, for example, of share-cropping contracts (in terms of sub-optimal worker effort and choice of technique) arising in a second-best situation of moral hazard problems can under certain circumstances be eliminated if the peasants own the land they till or have full access to credit to buy it (a land reform or credit reform). If all individuals had the same wealth (and the associated local risk-aversion characteristics), the need to transfer risks and hence the moral hazard problems of many principal-agent game situations in contractual arrangements would have disappeared.

Similarly, as we have already noted in Section II, differential access of farmers to working capital and own time endowment leads to a misallocation of resources, with land-to-labour ratios varying across farm sizes. Again, in the efficiency theory of wages and unemployment relating particularly to poor countries (with the crucial non-convexity in the consumption-ability relation of a worker at low consumption levels) one implication[9] is that a more egalitarian distribution of assets, by reducing the malnourishment particularly of the currently unemployed, is likely to lead to a rise in aggregate output in the economy. One could give many other examples, but by now it is fairly obvious that by giving up on the

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[8]For brief but excellent surveys of the issues see Stiglitz (1985a) and Stiglitz (1985b).

[9]For the development of this implication see Dasgupta and Ray (1986).

technology (as in the case of much of the so-called green revolution) may reduce the scarcity rent of land, unlike labour-saving mechanical innovations, and hence the landlords will adopt the latter over the former. An individual landlord will economize both on land and labour costs. But agricultural technology is often primarily generated in public research institutions and its diffusion is seriously dependent on public extension, credit and hydraulic works. If the landed oligarchy, sufficiently small and cohesive (overcoming the collective action problem), can influence state policies regarding research and diffusion, the nature of technological development may be affected, as has been claimed in the case of Argentine agriculture by de Janvry (1978). The neoclassical literature on induced innovations emphasizing factor scarcity and market prices usually ignores the interaction between dominant class interests and the relevant state policies. The Marxist literature, on the other hand, displays much too often a functionalist and conspiratorial attitude, suggesting that the absence of (or a particular bias in) technical progress must be there because it serves the interests of a particular class, without bothering to show the mechanism through which the class attempts and achieves the intended results.

3.2. The major claim of orthodox neoclassical economics that given well-defined property rights efficient resource allocation is independent of institutional arrangements or relations of production is largely irrelevant in the context of developing countries. That the serious and pervasive cases of market failures, incomplete markets, information asymmetry and moral hazard problems falsify the presumption of efficiency of resource allocation and make the latter crucially dependent on asset ownership structures and property relations is now well recognized, for

The models of institutionalists also suffer from inadequate specificity. While they may give a convincing reason why a particular institution exists or persists, they often fail to explain variations in the detailed structures and terms of contracts over time or across space. Blanket references to the 'power' of dominant classes cannot explain, except in a question-begging way, important differences in institutional arrangements. Marxists have also a tendency to equate sharecropping tenancy mechanically with the 'feudal' or 'semi-feudal' mode of production, thus ignoring how in the real world the same institution adapts itself to the development of the forces of production, with numerous cases of capitalist share-tenant farmers (as, for example, in Punjab) or more widespread cases of cost-sharing and other forms of landlord-tenant partnership in adoption of the new technology of high-yielding varieties in agriculture. Thus while Marxists have been most vocal in raising the issue of agrarian institutions and their interaction with technological development, the more substantive contributions in development theory in this respect have been carried out with neoclassical methodology looking into the micro-foundations of their rationale, drawing upon the growing literature on imperfect information, uncertainty, incentives and principal-agent games.

My other example relates to the case of labour-tying arrangements in agriculture. Historically, agrarian labour-tying brings to mind the blatant cases of obligatory service by the tenant-serf to the lord of the manor (as in the classic instances of European feudalism) or those of debt-peonage to moneylender-cum-landlord as prevailed in many parts of the world. These are clearly cases where tying involves a continuing lack of freedom on the part of the labourer and the sanctions underlying the employer's authority are based primarily on social or legal coercion. This separability between equity and efficiency considerations many neoclassical economists have now come a long way towards the position of the institutionalists.

3.3. Marxists and other institutional economists often refer to certain institutional constraints, taken as frozen data from history, and concentrate on their adverse effects on the use and development of the forces of production, overlooking the economic rationale of the formation of these institutions as well as how in the historical-evolutionary process the underlying rationale changes and the same institutional forms adapt and mutate in response to the changed circumstances. I shall give two examples from peasant agriculture, one from the profuse literature on land tenure and the other from that on labour transactions. First take again the case of sharecropping, which is often cited as an institutional obstacle to development. In their zeal for institutional change the Marxists usually ignore the origin and nature of this institution as an imperfect economic response to incomplete markets and market failures[10]: under a set of constraints, sharecropping does serve a real economic function, and its simple abolition without taking care of the factors that gave rise to this institution in the first place may not necessarily improve the conditions of the intended beneficiaries of the abolition programme. There are some important political lessons here from what may be called the economics of second-best reformism.

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[10]For a review of the literature relating sharecropping to market failures and imperfections in credit, risk and human and animal labour markets and costly monitoring of worker effort, see Newbery and Stiglitz (1979), Bardhan (1984a), Ch. 7, and Singh's chapter in Bardhan (forthcoming).

elaborate market segmentation which such personalization involves in poor economies frequently leaves the weaker partner in these transactions with virtually all-or-nothing choices. Of course, if the peasant is already pressed down to his reservation utility level, as in the principal-agent models of non-cooperative games, he cannot by assumption be worse off as a result of contract interlinkage. But in a bargaining framework, as in the Bell-Zusman (1976) tenancy model of Nash cooperative games, the peasant may be worse off with an interlinked set of transactions than with a set of separate bilateral bargains (even when the utility-possibility frontier itself shifts outward with interlinking). Neoclassical economists also fail to emphasize that personalized interlocking of labour commitments and credit transactions often divide the workers and effectively emasculate their collective bargaining strength vis-à-vis employers, who use this as an instrument of control over the labour process (as well as command of social and political loyalties).

Neoclassical economists (e.g., Ruttan and Hayami (1984)) who emphasize endogenous institutional innovations in response to changes in factor endowments or technology usually presume such innovations to take the general direction of greater efficiency. A faith in such a unilinear progress of history is also shared in some Marxian teleological schemes. Apart from the ambiguities in the welfare effects of improvements in efficiency when in the political process gainers usually do not compensate the losers, these views incorporate a kind of functionalism which is often indefensible and a-historical. An institution may benefit a group and yet the latter may have very little to do with its origin or maintenance; its mere function of serving the interests of beneficiaries is inadequate in <u>explaining</u> an institution. Dysfunctional institutions often persist for a is to be distinguished from the case where the labourer voluntarily enters long-duration contracts with his employer and reserves the right to leave unconditionally at the end of the specified period. This latter type of (implicit) labour-tying contracts is quite significant in agriculture in many areas. Neoclassical methodology has been quite useful in exploring their rationale[11] (in terms of 'labour-hoarding' for tight peak seasons, risk-sharing, productivity effects of continued relationships, incentive effects of selective exclusion, etc.), and in some cases it is not difficult to show why such contracts may even increase in importance with yield-increasing improvement and capitalist development in agriculture at least in the early phases. Yet most Marxists continue to identify all forms of labour-tying as 'bonded labour' and characterize them as symptoms of economic stagnation.

Many such implicit futures contracts in labour or land-lease markets of poor agrarian economies are cemented by credit relationships. By their very nature such interlocking transactions are often highly personalized.[12] Such personal ties between transacting agents are automatically described as pre-capitalist in the Marxist development literature, while in contrast the literature on implicit contracts and imperfect information in the context of industrially advanced economies often emphasizes the importance of what Okun (1981) called 'customer' (as opposed to 'auction') markets. Neoclassical economists who discuss the rationale of personalized interlinked contracts in these terms often, in their turn, overlook that the

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[11]See Bardhan (1983), and Eswaran and Kotwal (1985).

[12]For a review of the literature on this see Bardhan (1984a), Ch. 12, and the chapter by Clive Bell in this volume.

role, in comparison with factors like demography (changing factor endowments) or expansion of markets (and associative changes in specialization, scale economies and trade). Changes in factor endowments or market size or technology change the costs and benefits of collective action on the part of different classes, but cannot predetermine the balance of class forces or the outcome of social conflicts.

It is also important to note that the neoclassical emphasis on the locally efficient ('second best') nature of some of the contractual arrangements under the existing set of constraints should not divert our attention from the basic issue of removing those constraints (through, for example, appropriate asset redistribution). It is also underemphasized in the literature on the economics of information or that of transaction costs that moral hazard problems leading to work-shirking, costly monitoring, etc. are themselves partly the results of a specific and mutable set of social institutions: as Bowles (1985) notes, a more democratic organization of the work process and more egalitarian distribution of output may significantly reduce the Hobbesian malfeasance problems which form the staple of much of the principal-agent literature. Related is the important question of the role of ideology in the economic theory of institutions. North (1981) is the rare neoclassical economic historian who underlines the importance of social ideology in its function of reducing free-riding, shirking and venality so that the individual supervises himself and often behaves in a way contrary to the standard presumptions of principal-agent games. Marxists usually offer some useful clues (and some functionalist red herrings) about the structural roots of different ideological systems, but it is easy to see that we do not yet have a good theory of the formation, maintenance and institutionalization of ideology which lends some long period. Akerlof (1984) has built models to show how economically unprofitable or socially unpleasant customs may persist as a result of a mutually sustaining network of social sanctions when each (rational) individual conforms out of fear of loss of reputation from disobedience. Another self-reinforcing mechanism for the persistence of socially sub-optional institutions may be in operation when path-dependent processes are important, as is now recognized in the literature of the history of technological innovations. As Arthur (1985) has emphasized, when there are increasing returns to adoption of a particular (technological or institutional) innovation -- i.e., the more it is adopted the more it is attractive or convenient for the others to join the bandwagon -- a path chosen by some initial adopters to suit their interests may 'lock-in' the whole system for a long time to come, denying later, more appropriate, technologies or institutions a footing. The process is non-ergodic; there are multiple outcomes and historical "small events" early on may well decide the larger course of structural change. The historical-evolutionary process thus does not always move inexorably to the 'fittest' institutional form.

A movement towards a more efficient institution may also be blocked by the superior social, political and military power of the potential losers and by the problems of collective action that limit the ability of the potential gainers to get their act together. In an incisive analysis of European history, Brenner (1977) focuses on substantially different paths of transition from feudalism (the contrasting experiences of Western and Eastern Europe, of British agricultural capitalism and French small peasant proprietorship even within Western Europe) in which specific historical processes of class capacity for resistance and struggle play the crucial

4. Income Distribution and Growth

4.1. A fundamental difference in orthodox neoclassical theory from Marxist or structuralist-institutionalist theory relates, of course, to the determination of income distribution. In the former factor markets clear to determine factor prices, while in the latter they depend on class struggle or are given exogenously (with vaguely defined 'institutional' wage rates or mark-up rates). Contrary to popular impression, the difference does not lie in the neoclassical use of marginal-productivity relationships--as Marglin (1984) emphasizes, Marxian as well as Keynesian theories are quite consistent with the marginal-productivity equation, which is merely an implication of the competitive profit-maximization assumption--or of continuous factor substitution along production functions (which is, again, nothing inherently neoclassical[13]). It is the presumption (or model outcome) of markets not clearing, of involuntary unemployment, and, in some cases, of excess capacity that distinguish the other theories from neoclassical.

Here again the neoclassical theory and some of the Marxian theorizing have come close to each other. In the labour market, while most Marxists start with the presumption of a reserve army of labour (replenished whenever necessary by an unlimited supply from other sectors of the economy with petty modes of production), Marxists like Bowles (1985) have now tried to provide microfoundations to Kalecki's (1943) suggestion that capitalism

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[13]Elster (1983) takes some pains to show convincingly that the widely held view that Marx presumed fixed coefficients of production in industry is false. He cites many passages from Marx which imply that the capitalist has a choice of techniques and that he makes the choice on the basis of relative prices.

regular predictive ability to a model of institutional change that incorporates ideology. Among economists' infrequent attempts to analytically understand ideology, the ones that may be most useful towards explaining institutions in poor countries are those by Akerlof (1984), particularly his work on class loyalty ('loyalty filters'), cognitive dissonance (how people handle unpleasant conditions by adjusting their beliefs to their constraints) and the concept of fairness (in wage and work norms, for example).

In propagation of ideology and the socialization process as in defining and enforcing property rights the state plays the authoritative role. Neoclassical explanations of institutional arrangements are usually not very sensitive to the linkages between such arrangements at the local level and macro political forces and to the frequent fact that the state for reasons of maintaining its own support structures may prolong socially inefficient property rights. By drawing pointed attention to the role of ideology and the state in his explanation of the processes of institutional change North (1981) has brought the neoclassical theory of economic history very much closer to the Marxian.

raised theoretical and empirical doubts in the cases both of permanent and, particularly, casual labour contracts.

Analogous to the case of unemployment equilibrium in labour markets, the neo-neoclassical theory provides an explanation of equilibrium in the capital markets, characterized by credit rationing and excess demand for capital. In a situation of imperfect information, as Stiglitz and Weiss (1981) show, the expected utility of the lender may go down even as the interest rate increases on account of adverse selection effects and higher risks of default on the part of all borrowers. In the closed face-to-face village communities some of the information problems and adverse selection effects are less acute; repeated situations, reputation effects and inter-linked contracts (between credit and tenancy or wage labour) relieve some of the default risks. On the other hand, strong covariate income risks and synchronic timing in agriculture limit local deposit banking and financial intermediation.[15] Such intermediation on any substantive scale has to come from outside, but for an outsider the information problems mentioned above reappear. With such information and other transaction costs acting as barriers to entry, the local lender may enjoy territorial monopoly powers in charging usurious interest rates and in undervaluing collateral assets provided by the borrower.[16] Of course, in these situations the monopoly power of the lender need not always be reflected in usurious interest rates (even abstracting from the fact of social control that the lender may like to exercise over his borrowers instead, as some Marxists emphasize), just

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[15]See Binswanger and Rosenzweig (1986) on this point.

[16]Bhaduri (1977) has emphasized undervaluation of collateral as a way of turning lender's risk into borrower's risk.

uses unemployment as a worker discipline device: given a positive cost of surveillance and a conflict of interest between employer and worker over work effort (extraction of labour power from labourers), the wage rate offered even by the competitive profit-maximizing employer will exceed the market-clearing wage and equilibrium entails unemployment. This is, of course, very similar to the models of involuntary unemployment in Calvo (1979), Eaton and White (1982), Stoft (1982) and Shapiro and Stiglitz (1984). While these models were not specifically designed to represent labour markets in developing countries, one may say that in these markets the possible substitutes for the threat of unemployment (in creating work incentives) in the form of job entry fees or employment bonds or fines are less likely to operate, whereas threats in the form of losing credit from the employer-cum-lender if caught shirking work are more plausible.

Employers may also offer wages in excess of market clearing to reduce costly labour turnover, as in the urban labour market model with training costs in Stiglitz (1974) or the rural labour market model with recruitment costs in the peak season in Bardhan (1984), Ch. 4. These are all special cases of a general relationship[14] between labour productivity (or costs) and the real wage paid by the employer, in which case it is possible that market equilibrium will be characterized by unemployment. The original model where this hypothesis was first advanced was that of Leibenstein (1957) where a nutritional relationship between worker efficiency and wage was posited. But Bliss and Stern (1978) and Bardhan (1984), Ch. 4, have

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[14]For a review of the issues in the context of developed and developing countries, see Yellen (1984) and Binswanger and Rosenzweig (1984) respectively.

territorial segmentation[19] of the labour and credit markets blocks supra-village class solidarity.

4.2. While in neoclassical growth models distribution of income responds to growth, in the demand-driven models of structuralists income distribution clearly affects the rate and pattern of growth. In the development literature in Latin America and India existing income inequality and mass poverty in the countryside are sometimes found to pose severe limits to the expansion of home market for manufactured goods. As Lustig (1980) points out, this market insufficiency theory is quite different from Marxist realization crisis theories, and is more akin to the underconsumption thesis of Sismondi and later some Russian populists (like Nicolai-on and Vorontsov). In Dutt's (1984) model, with differential saving propensities of capitalists and workers, a regressive income distribution lowers consumption demand, which through an accelerator effect depresses investment demand, profits and growth. Some of the Latin American structuralist writers, however, imply quite the opposite: increased income concentration may solve the problem of underconsumption in the key consumer durables sector. In the model of de Janvry and Sadoulet (1983) there is a critical level of income inequality above which such a process of what they call 'social disarticulation' always obtains. The results are more ambiguous in the more general two-sector growth models of Taylor (1983a, Ch. 9; 1983b). One sector produces wage goods while the other produces consumption goods for profit recipients and capital goods. Shifts in distribution in response to shifts in demand composition are

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[19]For empirical evidence on such territorial segmentation, see Bardhan and Rudra (1986).

as in commodity markets when monopolists know their customers' demand schedules, they may not charge monopoly prices; they may instead lower prices to the level that would prevail in competition and extract the additional consumer surplus by imposing flat entry charges or by some tie-in mechanism like interlinked contracts.[17]

The Marxist economist's emphasis on class power and class alliances in understanding income distribution is clearly crucial, as long as one keeps in mind that class formation (particularly in the sense of what Marx called class-for-itself) among the poor in many parts of the world is yet in its infancy. But to leave wage theory entirely up to the political process and the balance of class forces is analytically unsatisfactory for an economist, particularly in the face of accumulating evidence[18] that wage rates are often quite sensitive to market pressure even when markets do not clear. When class struggle takes the form of some formal or informal collective bargaining, the good old neoclassical demand-supply framework may provide indispensable clues in understanding the 'disagreement payoffs' in any bargaining game and in delimiting the possible range of wage indeterminacy. It may also be useful in assessing the nature and intensity of pressures in the political lobbying process on incomes policy. Again, Marxists usually leave the domain of class struggle unspecified; information costs and moral hazard problems may, for example, delimit the 'moral' boundaries of a village community and partly explain how the consequent

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[17]For an application of this idea in the rural credit market, see Basu (1984) and Bardhan (1984), Ch. 6.

[18]See Bardhan (1984), Ch. 4.

production, in marketing and other transaction costs, and in mobilization of finance) in ways which the constant returns to scale assumption of many neoclassical models cannot handle, and the distance from the poor widens. If preferences are socially determined as Marxists claim, the experience of the poor makes them less future-oriented and hence less likely to be full participants in the growth process.

Differential consumption propensities and sectoral demand composition have been used in the well-known Bacha-Taylor (1976) model of 'unequalizing spiral' of growth. It is a three-sector model (wage goods, luxury goods, capital goods) with production requiring fixed ratios of capital to 'effective labour' in all sectors, fixed relative wages of skilled to unskilled labour, infinitely elastic supply of unskilled labour, the latter consuming only wage goods while the skilled also consume luxuries as well as save, and investment demand functions in the non-wage good sectors responding readily to output. In such a model growth starts a whole cumulative process in which a rise in skilled employment, in relative demand for luxury goods and in investment in the luxury sector feed on one another, accentuating inequalities all along. While the behavioral foundations of such models need to be spelled out more clearly, I find them yielding more insights into the distribution process than all the fine tuning of some neoclassical models.

On the question of income distribution effects of capitalist growth the Marxists and institutionalists are usually on the same side vis-à-vis the neoclassicals. But there is some tension between the Marxists and other institutionalists (whom the Marxists, echoing Russian debates of the late nineteenth century, sometimes disparagingly call neo-populists) on some implications of large-scale capital-intensive capitalist or shown to depend on labour intensity of the sectors (as in neoclassical models), while growth effects depend on the sectoral sensitivity of investment demand functions to profit rates. An increased income inequality may induce faster growth if the investment response of the non-wage good sector capitalists to higher profits is strong enough. While in a system with excess capacity it is important to take account of the dependence of growth on investment demand, it is not clear, as Buffie (1984) comments, why and how the degree of excess capacity and the average profit rate influence the current investment demand in Taylor's long-run model. The ad hoc specification of mark-ups which is customary in these models is also unsatisfactory.

4.3. Let us now turn to the impact of growth on income distribution. The differences in the alternative approaches are quite familiar on this question and we shall be brief. Neoclassical economists, apart from pointing to the equalizing impact over time of concave saving functions--as in Stiglitz (1969)--and the opposite effect of a higher rate of population growth among the poor, usually offer the comforting hypothesis of 'trickle-down.' They are invariably most scathing on the possibility of immiserizing growth under policy-induced price distortions. Marxists and the structuralists usually emphasize the existing institutions which perpetuate and reinforce inequalities with capitalist growth. A major focus is on differential access to capital, which tends to result in differential flow of benefits from technical progress (as, for example, in the case of the so-called green revolution). Similarly, unequal initial endowments and "connections" lead to unequal benefits from human investment and migration, to entry deterrence in quality jobs, and to further polarization. The rich can take better advantage of economies of scale (in

But the questions of the distribution effects of inappropriate technology and sectoral bias in production and investment allocation remain even under socialism and state-led industrialization. Some critics of socialist industrialization programmes in the mixed economies of some developing countries trace an alleged bias towards squeezing the agricultural sector to the net effects of the legacy of the 1920's Soviet discussion of the problems of what Preobrazhensky (1926) called 'primitive socialist accumulation' on early planning literature and of the traditional Marxian distrust of peasants. But at an analytical level the price or tax policies (of Preobrazhensky and his latter-day followers among development economists) aimed at mobilizing agricultural surplus essentially incorporate not an anti-peasant bias as such, but the imputation of a relatively large social weight to investment as compared to current consumption.[22] The same imputation of a low social rate of time discount calls for the choice of relatively capital-intensive techniques in industrial production even in the face of a large supply of underemployed labor (which may look like the working of an anti-worker bias), as has been shown in Dobb (1960), Sen (1960) and Marglin (1967); or in investment allocation with sectoral non-shiftability of capital for an emphasis on basic capital goods

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(Footnote Continued)
example from a letter he wrote in 1878 to the Editor of <u>Otechestvennye Zapiski</u> refuting an article by Mikhailovski:
"He (Mikhailovski) absolutely insists on transforming my historical sketch of the genesis of capitalism in Western Europe into a historico-philosophical theory of the general course fatally imposed on all peoples, whatever the historical circumstances in which they find themselves placed.... But I beg his pardon. That is to do me both too much honour and too much discredit."
An English version of this letter is now published in Shanin (1984).

[22]For a lucid demonstration of this see Sah and Stiglitz (1984).

state-socialist industrialization. These implications often involve 'inappropriate' technology,[20] shrinking of employment prospects particularly for marginal groups in the labour force, urban bias, squeezing of surplus from the poorer agricultural sector, 'de-skilling' of artisans in traditional handicrafts, marginalization and pauperisation of small proprietors and so on. Most Marxists are sensitive to these problems, but some of them are regarded by them as inevitable costs of the development of the forces of production. As Emmanuel (1982) bluntly puts it, "if capitalism is hell there exists a still more frightful hell: that of less developed capitalism." In the advocates of small-scale labour-intensive production and of 'basic needs' Marxists often detect an anti-industrialization bias and a nostalgia for the vanishing petty modes of production (this is reminiscent of Marx's comments on the so-called utopian socialists and anarchists of his time). Some Marxists, however, are more sympathetic: on capital-intensive technology they even point out that machine-paced operations may be introduced by capitalists not for higher direct productivity but for larger control over the labour process and work discipline; in response to comments like that of Emmanuel above some of them reject the unilinearity of the stages of history, regard the social and human costs of capitalism avoidable and envisage leap-frogging from pre-capitalism direct to socialism.[21]

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[20]For a simple theoretical model of the adverse distributional implications of inappropriate technology in the context of localized technological progress, see Lapan and Bardhan (1973).

[21]There is growing evidence that in the last decade of his life Marx himself was, hesitatingly, toying with such ideas, favorably reacting to Russian populists, of skipping the stage of capitalism. Let me quote one (Footnote Continued)

5. Trade and Development

5.1. A major point of apparent conflict between neo-classical (or classical) and Marxist views that looms large in development economics centres around the idea of gains from trade and specialization. Liberal economists never tire of emphasizing the benefits of voluntary exchange based on comparative advantage (with appropriate qualifications for learning by doing, externalities, diversification as insurance against market risks and so on). At the other end there is a large number of development economists, some, though certainly not all, of whom are associated with the Latin American dependency school (both Marxist and non-Marxist), who are deeply suspicious of trade contacts and foreign economic 'intrusions,' based on the historical experience of oppressive relationships between the 'centre' and the 'periphery.' Some of the heat generated in the debates between the two sides is, of course, attributable to misunderstanding of each other's position and talking at cross-purposes. For example, (if we leave aside international relations of plunder or tribute and focus on market exchange) it is quite consistent for the 'periphery' to gain from trade with the 'centre' (in the Samuelsonian sense of having the opportunity to trade as better than being denied that opportunity), and yet for the former to be exploited by the latter in the Marxian sense (that the former would have been better off in the counterfactual world of a more egalitarian international distribution of assets),[24] just as in a capitalist society the assetless worker gains from trading his labour power (as opposed to not working for the capitalist), and yet is exploited in the Marxian sense.

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[24]For a rigorous exposition of this idea in the context of the unequal exchange literature, see Roemer (1983).

industries as opposed to consumer goods industries, as is suggested in the planning models of Feldman (1928) and Mahalanobis (1953). The presumption of a low social rate of time discount and the consequent consumption sacrifices on the part of workers and the peasants for the sake of investment in capital-intensive industrialization programmes are, however, hard to justify[23] in situations of increasing inequality, unemployment and the government's frequent inability to control conspicuous consumption of the rich and wastage and graft in the public bureaucracy, and the white elephants in the state-run industrial sector.

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[23]For an analysis of the sub-optimality of collective savings and the 'prisoners' dilemma' aspect of the social rate of time discount, see Sen (1984), Chs. 4 and 5.

recognized in standard trade theory, given the high income elasticity of import demand in the periphery, relatively low world demand for many of its exportables and the monopoly power of giant trading companies of the centre. Bacha (1978) has thus couched this aspect of Emmanuel's problem in an extended Prebisch-Singer framework. If, however, prices cannot be relied in this model to ensure balance of payments equilibrium and one allows for quantity adjustments, Ocampo (1985) shows that there may be a trade-off between terms of trade and employment level in the periphery, so that less unequal exchange may entail higher unemployment.

5.2. Marxist theory, of course, goes beyond static distribution effects of trade and other transactions with foreign countries. The theory of imperialism emphasizes the dynamic effects (some positive, some negative) of foreign capitalist penetration of underdeveloped economies. Marx and Engels primarily stressed (though with growing reservations in their later years) the historically progressive role of colonialism and trade, with their 'brutal but necessary' function of destroying pre-capitalist structures. Marxist writers on imperialism at the turn of the century (Lenin, Luxemburg and others) pointed to the ambiguous role of foreign capital, the weak and dependent nature of local bourgeoisie and the tendency of the international division of labour to confine colonial production to mineral and agricultural primary products. In more recent years writers like Baran (1957) and many of his direct or indirect followers in the dependency school[26] have gone farther and seriously questioned the viability of capitalist development in underdeveloped countries integrated into the

[26]Palma (1978) has traced the Marxist origin of the main ideas of this school to the Sixth Congress of the Communist International in 1928.

There is also often an elementary confusion among some Marxists about the meaning of a nation's 'gain' that the liberal economist imputes to trade: he means potential gain with appropriate inter-group redistribution. In the absence of such redistribution, the gain may accrue only to a 'comprador' class with the majority of people actually losing from trade. To the extent Emmanuel's (1972) idea of unequal exchange refers to a transfer of value from the capital-poor periphery to the capital-rich centre in the process of international trade, it thus does not negate the neo-classical idea of potential gains from trade.

This is not to deny the very important differences between the Marxian and neo-Ricardian models[25] of trade on the one hand and the neoclassical on the other, particularly in terms of the role of circulating capital as an independent determinant of comparative advantage and of income distribution, which in the neoclassical model is endogenously determined but in the other models depends on different historical and institutional processes in the trading countries (including differential worker bargaining power and modes of production in the center and the periphery). It should also be noted that the standard neoclassical treatment of gains from trade, which involves a comparison of hypothetical autarchic equilibria, usually underplays the fact that such a comparison may not be meaningful when the process of trade itself changes factor availabilities, utilization of scale economies, technologies and even demand patterns.

To the extent unequal exchange refers to the real possibility of unfavourable terms of trade for the periphery, this has long been

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[25]See the chapter by David Evans in this volume for a discussion of neo-Ricardian trade models.

these countries, but the issue of unpleasant aspects of capitalist growth should surely be kept separate from that of viability of capitalism. Some Marxists now recognize the overemphasis in the dependency literature on the process of <u>circulation</u>[27] (as opposed to the process of production), its unduly stagnationist perspective and the neglect of the complex role of the state. Neoclassical economists, on the other hand, completely ignore the historical role of foreign trade and investment in altering the structure of property rights in the economy, the balance of class forces in civil society and the nature of the state.

Largely inspired by the Marxist and structuralist comments on the history of international transactions between the center and the periphery, there now exist a large theoretical literature on the so-called North-South models, focussing on the asymmetry in structure and performance of the two aggregative trading groups of countries. In different models one or more of the following kinds of asymmetries in the features of the center and the periphery have been assumed:

(a) differential income elasticities of demand of importables and exportables as in the standard Prebisch argument;

(b) asymmetry in product market structure, with mark-up pricing and monopoly rent from product innovations in the center;

(c) asymmetry in labour market conditions, with inelastic labour supply in the center and unlimited labour supply in the periphery, as in the Solow-Lewis model of Findlay (1980), and with wages in the periphery equal to average productivity of labour in

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[27] For Marxist criticisms on this line see Laclau (1971), Brenner (1977), and Cardoso and Falleto (1979).

world economy, in view of surplus expropriation by foreign capital in alliance with domestic pre-capitalist oligarchies. Ironically, pessimism about prospects of peripheral capitalism reached new heights among these writers of the dependency school precisely in the decades when many of these less developed countries were experiencing a substantial expansion in capitalist growth and trade. As Cardoso (1977) remarks, 'history had prepared a trap for pessimists.' Foreign capital and transnational enterprise have led to a rapid capitalist transformation of some of these economies (examples: pre-debt-crisis Brazil, Mexico, Malayasia); on the other hand, industrial growth was very slow in countries like Burma which adopted a policy of virtual delinking with foreign trade and investment interests, or like India which compared to most other major non-socialist developing countries followed a substantially autarchic policy. The dramatic cases of growth in some of the East Asian 'open' economies (like South Korea or Taiwan) have even started posing a competitive challenge to the industrially advanced economies in many sectors.

Much of this growth cannot be described as 'dependent' development. In this process, as in the earlier phase of nationalization of foreign investment in the extractive industries and public utilities in most countries, the state along with the domestic capitalist class has played the decisive role. Even in Brazil, where the military regime had a strong commitment to the internationalization of the domestic market with a substantial involvement of the transnationals, a tight integration of state and local private capital transformed some of the leading sectors in Brazilian growth, most notably the petrochemical sector (see Evans (1982)). Of course, many critics have elaborately commented on the negative consequences of the uneven, lopsided, 'disarticulated' pattern of growth in technical progress in advanced countries and the entry deterrence involved in the large fixed costs in learning and adaptation of new technology.

5.3. One major difference in the structuralist literature on trade and development from the neoclassical has traditionally been the empirical pre-judgment in the former of price inelasticities of demand and supply and of varying degrees of export pessimism. Chenery's famous two-gap model was an early attempt to theoretically examine the consequences: how the ex ante desired level of investment may not be realized due to lack of foreign exchange to pay for imported intermediate and capital goods. In the neoclassical literature the investment level implied by the savings constraint can always be reached through reductions in competitive imports (or increases in competitive exports) which free the necessary foreign exchange for investment purposes. Neoclassical economists also point out that even when there are serious restrictions on expansion of exports of all developing countries taken together, an individual country's exports may be more price-sensitive and may depend more on domestic factors of demand, supply and trade policy. To this the structuralist answer is that in a non-Walrasian world even a "small" country can face a foreign exchange bottleneck, with its exports restricted by Keynesian unemployment in other countries, not necessarily by domestic excess demand. The foreign effective demand constraint on exports may ease over time if domestic prices go down as unused capacity emerges; a lower real exchange rate may then improve exports. Bacha (1984) has extended the two-gap model to the case where capital movements assume the form of interest-bearing foreign debt: credit rationing in world capital markets may still keep a developing country under a binding foreign exchange constraint. In a disequilibrium macroeconomic model Arida and Bacha (1984) show that the structuralist the food sector and strong unions in the production of exportables in the center, as in the extended Lewis model of Bardhan (1982);

(d) rigidities in output in the periphery, whereas the centre is a demand-driven Keynes-Kalecki economy, with supply perfectly elastic at a price equal to a mark-up on variable costs and employment and output determined by investment, as in the models of Taylor (1983), Ch.10 and Kanbur and Vines (1986);

(e) the larger initial capital stock in the center allowing for larger external economies of scale in the production of manufactures, and with profits reinvested larger cumulative advantage in manufacturing, as in the model of Krugman (1981);

(f) asymmetry in the generation and diffusion of technical progress in the form of both product and process innovations.

Many of these models confirm the original Prebisch insight that productivity improvements in export production may be transferred through a worsening of the barter terms of trade for the periphery, but retained through higher real incomes in the center. In the Solow-Lewis model improvements in productivity or thrift benefit the periphery in the form of larger employment. As expected, in the Keynes-Kalecki economy thrift is not a blessing. As contributions to the literature on uneven development, items (e) and (f) seem much more promising, particularly emphasizing the cumulative process involved in economies of scale in production, information gathering and acquisition of technological capability. The advantage of backwardness emphasized in Findlay's (1978) model of technological diffusion is often more than outweighed by the localized nature of in many cases, is not a necessary, and certainly not a sufficient, condition for successful industrialization.[28] The neoclassical presumption of perfect tradability is invalid in the case of many industrial products and elements of technology to be assimilated, with some of them actually inherently non-tradeable. This may call for selective government intervention, rather than the neutral incentive regime of neoclassical policy literature. Welfare losses from lack of coordination and integrated decision-making with imperfect tradability under increasing returns may be relatively large, even in comparison with the empirical estimates of losses of misallocation under policy-induced distortions that the neoclassicals have marshalled. If managing the local acquisition of technological capability, more than factor accumulation or allocation, is at the core of industrialization, the catalytic role of strategic and selective intervention is imperative in information gathering, in encountering indivisibilities in effective assimilation of new knowledge, in bargaining terms of technology agreements, in underwriting risks and raising credit in providing marketing infrastructure, in coordinating rationalization in established industries, in minimizing the social costs of dislocation in industrial reorganization, and, in general, in sailing the uncharted waters of potential dynamic comparative advantage, as the recent history of Japan and South Korea amply demonstrates.

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[28]A good analysis of some of the main issues, particularly in relation to technological change, that we have drawn upon is that of Pack and Westphal (1986).

viewpoint correctly apprehends the nature of disequilibria when the goods market is in excess supply, but, on the other hand, an economy can present unemployment, external deficit and excess supply of goods, apparently confirming the structuralist diagnosis, and yet, a Walrasian equilibrium may exist, suggesting that exchange rate devaluations may be called for.

5.4. A superb result of neoclassical trade theory, attributable largely to the Bhagwati-Ramaswami (1963) model of domestic distortions and optimum trade policy, has delinked the traditional association between the advocacy of liberal trade policy and that of laissez-faire in domestic economic policy. It became easier to be an avid interventionist in domestic economic matters, and yet remain a liberal trade theorist maintaining the position that trade restriction is not the first-best policy to tackle most problems of a (small) economy. Since then -- as Little (1982) reports in a triumphant account -- a formidable combination of neoclassical trade theory, project evaluation theory, empirical studies of the high cost of restricted foreign trade regimes and glowing accounts of "outward-oriented" East Asian success stories has effectively challenged and undercut the basis of a pronounced anti-trade bias in the early structuralist development literature. While the latter definitely needed the challenge of clear rigorous thinking and the neoclassical offerings indisputably contain many gems of first-best wisdom, I think in the n-th best world of practical politics, industrial strategy, imperfect tradability, incomplete markets and costly acquisition of technological capability the clear-headed structuralist need not concede too much (even though he will have to give up vestiges of any "knee-jerk" protectionism).

The standard neoclassical prescription of 'getting the prices right' and bringing them in line with international prices, even though desirable

6. Economic Policy and the State

6.1. The immediately preceding discussion has already brought us to the question of policy-making and the state. Early development economics often displayed an unquestioning faith in the ability of the state to correct market failures and imperfections and to effectively direct the economic process towards development goals. After the experience of massive government interventions of the last few decades in many developing countries, the literature has now turned full circle; it is now full of gory neoclassical accounts of 'public failures' of regulatory, interventionist states. The neo-neoclassical economists emphasizing transaction costs and imperfect information see problems on both sides: on the one hand, the traditional neoclassical models ignore that under information-theoretic considerations the market equilibrium is in general not Pareto-efficient, that it may not be possible to decentralize efficient resource allocations and that information exchange often takes place through signals other than prices; on the other hand, the information problems involved in adverse selection and moral hazard are no less acute for the planning or regulatory authorities than for the private sector. While there are problems on both sides and they sharply differ from one historical situation to another, one need not always take an agnostic position on this matter even on a priori basis. Of the different items of transaction costs, identification costs and enforcement costs may be lower under private market institutions (individual actors may locate one another more easily than government agencies and self-interest rather than command may be a better enforcer), but negotiation costs may be lower under administrative institutions and there may also be some economies of scale in administrative enforcement. In particular, when prisoners'-dilemma type collective action problems are

It is by now well known[29] that the favourite neoclassical showcase of South Korea is not predominantly one of market liberalism but of aggressive and judiciously selective state intervention. The Korean state has heavily used the illiberal compliance mechanisms of selective command and administrative discretion, restricting imports for industrial promotion, disciplining the private sector through control over domestic credit, foreign exchange and underwriting of foreign borrowing, and public enterprises leading the way in many areas. It is not that the South Korean state has always (or even primarily) used the first-best policies of the neoclassical distortion literature, some of their policy instruments are basically the same as the ones that have drawn neoclassical wrath in slow-growing "inward-looking" economies. But they have used these instruments with speed and flexibility, tackling economic targets like a military operation. Neoclassical economists are, of course, right in pointing out that the export-orientation of the Korean state has allowed for larger utilization of scale economies in promotion of infant industries and that the state's alertness in using the signals emanating from world markets to judge dynamic efficiency has helped in keeping firms on their toes.

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[29]See Jones and Sakong (1980), Pack and Westphal (1986).

literature[30]) where the state passively responds to rent-seeking behaviour or directly unproductive profit-seeking activities of various interest groups and lobbies. The neoclassical emphasis is on the social wastage of resources involved in such political processes.[31] This waste is measured as a deviation from the competitive equilibrium--a hypothetical alternative without any information, transaction or political costs. This seems to me a comparison of very limited value; as North (1984) points out in this context, "there is no meaningful standard of Pareto efficiency possible, since one cannot specify a least-cost structure of government for any given economic output." One can, however, allow for costs of government and define wastage as occurring only when resources are diverted beyond what is accounted for by these costs. The use of Pareto criterion is inappropriate also because the major focus of political processes is distribution. The neoclassicals routinely show how given the outcome of the political process, one could do better since it is away from the utility-possibility frontier, but that does not prove that any given market outcome, which is presumably on the frontier, is necessarily better: the two actual outcomes may be, and often are, Pareto-incomparable.

More important than the static misallocation effects of the politics of clientelism are its dynamic effects on the processes of accumulation. Olson (1982) has emphasized the prisoners' dilemma type problems that arise

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[30]For a collection of articles in these and other strands of the neoclassical literature, see Collander (1984).

[31]As Milgrom and Roberts (1987) point out, within the hierarchical organization of the capitalist firm, where there is a great deal of centralization of authority, the costs of various kinds of "influence activities" can also be considerable.

important or economies of coordination, as in situations of industrial and technological strategy discussed in the preceding section, are significant, private market mechanisms are particularly deficient. Similarly, in risk-pooling and in concentrating resources to start a process of cumulative causation, as is often the case in early industrialization, central mediation and planning have important functions to perform. It should also be stressed that our discussion should not be confined to the polar opposites of private market and centralized bureaucracy; there may be many small-group cooperative institutions which may avoid some of the 'failures' of the two poles and adequately reconcile problems of equity and efficiency.

6.2. Much of the policy discussion (neoclassical or institutionalist) in development economics is often conducted in a political vacuum. Economists are quick with their suggestions for improving allocation efficiency, accumulation or income distribution, but governments are frequently slow in implementing them or sometimes even inclined to go in the opposite way, not necessarily because they lack the awareness or the advice. Our theories of economic policy need a good theory of the state. Marxists are usually more forthcoming in spelling out their theory of the state than the others, but more often than not it is of a rather crude instrumentalist variety, with the state as a direct tool of the dominant class (or in the slightly more sophisticated version, the state has 'relative autonomy,' acting not at the behest of, but on behalf of, that class).

The state is also passive in the recent neoclassical theories of political economy (whether in the public choice or the international trade decisions and the hierarchy of agents, the bureaucracy, which is supposed to implement those decisions. The process of implementation often generates various kinds of rental income which, to a significant extent, accrues to the bureaucracy and the latter forms a pressure group to secure this income flow, with goals which are often much narrower than those set by the state elite. The impulses that shape major policies and actions by the latter are fuelled not merely by motives of self-aggrandizement but quite often also by what Miliband (1983) calls its 'conception of the national interest' in a way that the neoclassical theories of predatory or rentier state or North's (1981) revenue-maximizing discriminating monopolist state or the simple Marxist class-driven state somehow fail to capture. In many cases of state-directed industrialization this leadership genuinely considers itself as the trustee of the nation's deeply held collective aspirations and derives its political legitimacy from them. In a world of international military and economic competition one, though not the only, form these aspirations often take is to strive for rapid economic development.

None of the existing theories of the state, however, provides a satisfactory general theoretical explanation of how different interventionist states with command over roughly similar instruments of control end up being a developmental state in some cases (example: South Korea) as opposed to a primarily regulatory one in some others (example: India), or for the same country (say, South Korea) pass from a preoccupation with zero-sum rent-seeking (in the Rhee regime) to a dynamic entrepreneurial state (as in the Park and Chun regimes). Clearly, many international and historical conjunctural forces and path-dependent sequences (like those we have emphasized at the end of section III) are important here.

in the context of a multiplicity of pressure groups and the consequences they have for the performance of an economy over time. Bardhan (1984) has extended this to the case of a large and heterogeneous coalition of dominant classes (with multiple veto powers) in contemporary India and used this collective action problem as part of an explanation of the frittering away of investible surplus in the form of public subsidies and of indifferent management of public capital, resulting in slow industrial growth.

The Indian example also suggests that the state today is much more powerful than is visualized in the Marxian or neoclassical political economy of class or pressure group politics. In many developing countries, the state controls the 'commanding heights' of the economy, owning a large part of the non-agricultural economy and regulating the flow of credit, foreign exchange and investment licenses. To a large extent it can play one class against another, local capital against foreign, one transnational company against another, all for the purpose of furthering its own goals. This is not to deny that the articulated interests of organized classes and pressure groups act as serious constraints on policy formulation and, particularly, implementation, but to focus exclusively on them is to ignore the large range of choices in goal formulation, agenda setting and policy execution that the state leadership usually has. I think both Marxist and neoclassical political economy err in taking the state merely as an arena of group competition and in not including the state itself as a strategic actor in a game of mixed conflict and cooperation with other groups. The state as an autonomous actor should not be identified with the bureaucracy (as is usually done in the neoclassical political economy literature). One should distinguish between the top political leadership representing the state (let us call it the state elite) which takes the general political

7. Concluding Remarks

In conclusion let me briefly refer to Hirschman's (1982) sad account of development economics, reeling, as he describes it, under 'attacks' from neo-Marxist as well as neoclassical writings, and 'wounded' by a series of political disasters in developing countries. In response to Hirschman's premature obituary of development economics, it is, of course, easy to point out that it is alive and well, at least its vital signs are no less pronounced than those in the rest of economics. But what Hirschman was really referring to was the marked decline in the initial tempo and expectations (at least those in the minds of the pioneers of the subject, of which he was clearly one), and in the confidence of a brash young sub-discipline that 'it could slay the dragon of backwardness virtually by itself.' In some sense it is better that the subject gets over its initial delusions of grandeur sooner than later, and settles down to its enormously complex, concrete, if mundane, tasks. 'We may have gained in maturity,' as Hirschman consoles himself, 'what we have lost in excitement.'

In this maturation process not merely have we seen the 'big-push' enthusiasm of some of the development economists of the 1950's dampened by the subsequent _dirigiste_ excesses, autarchic inefficiencies and adverse distributional consequences of some industrialization programmes, but we have also seen the feet of clay of some of their neo-Marxist and neoclassical challengers. In contrast to the missionary zeal of these contending early protagonists, we are now somewhat more circumspect in rallying to partisan causes and more sensitive to problems and pitfalls on all sides. In our heretical eclecticism we have even suggested in this paper that the differences between alternative approaches are now narrower than are

In general discussions of policy implementation it is customary to ascribe chronic failures to a lack of 'political will' (whatever that means) or a lack of 'social discipline'--with which Myrdal (1968) characterized his 'soft' states. In the context of economic growth it is rather the capacity of the system to insulate economic management from the distributive demands of pork-barrel politics that seems to make the crucial difference. The South Korean state under an authoritarian military regime has centralized decision-making power in the executive branch, granted considerable operational space to economic technocrats and carried out a corporatist restructuring of relations with labour, business and the rural sector to an extent unmatched even by the Latin American states at the peak of their so-called bureaucratic-authoritarian phase. But authoritarianism is neither necessary nor sufficient for the insulation process. Japan manages to have a high degree of such insulation with a reasonably liberal democratic government. Myrdal's own Sweden is another such example. On the other hand, the authoritarian regimes of many developing countries have not succeeded in isolating the management of the public economy from the ravages of rent-seeking processes. It is sometimes suggested that if the politics of a given developing country is 'messy' and the state lacks the ability to insulate, then it better be non-interventionist and leave things to neoclassical first-best rules, so the least amount of vested-interest structures are created. I find this naive, as the very reasons why insulation is infeasible are often also the ones which will make first-best policies inoperative and, in the inevitable absence of lump-sum redistribution a policy of relative inaction may be distributionally unacceptable.

some of these areas and Marxists, who are not unduly worried about 'tainted' tools, can profitably borrow from neoclassical methodology. There is no denying that the 'great' questions of economics or history are usually asked first by the Marxists, even though we may not always accept their pre-digested answers or may insist on explanatory mechanisms and processes even when the answers are broadly acceptable. The neoclassicals, who are usually more refined in their spelling out of the causal mechanism in an implicit social process of 'natural' selection, are often insensitive to their institutionally aseptic assumptions and a-historical categories; in their obsession with the minutiae of 'getting the prices right' they often get their historical and institutional environment wrong. As we have mentioned before, some of the neo-neoclassical models now fully recognize the crucial dependence of efficiency of resource allocation on asset ownership structures and property relations. Similarly, some of these non-Walrasian models have given up on market-clearing factor prices and explored the microeconomics of equilibria with involuntary unemployment and rationing. Similar bridge-building between the alternative approaches has been attempted by rational-choice Marxists in tracing the micro-foundations of class analysis in postulates of individual behaviour and in general in using the techniques of game theory in understanding social interaction and historical change in situations of interest conflicts. Such attempts at exploration of each other's territory, in spite of the withering scorn of purists on both sides of the barricade, are refreshing and likely to increase in future. But at the same time we should recognize that the economists on <u>both</u> sides are better-equipped to handle 'interests,' rather than 'passions' (to use Hirschman's eloquent distinction) that move individuals and social groups, and that both usually share a limiting vision of generally perceived[32] and that there is some scope for culling valuable insights from all of them, without underplaying their still substantially different perspectives.

In development economics, as in much of social science in general, the most valuable contribution of the Marxist approach is the sense of history with which it is imbued, its focus on the tension between property relations and productive potential in a given social formation, and on the importance of collective action and power in enhancing or thwarting processes of institutional change to resolve that tension, its insistence on bringing to the forefront of public policy debates an analysis of the nature of the state and the constellation of power groupings in civil society, and, of course, its abiding commitment to certain normative ideas on questions of exploitation and injustice. Its processes of reasoning, however, leave much to be desired, with its frequent substitution of convenient teleology for explanatory mechanisms and of a kind of murky institutionalism for a rigorous rationale of (formal or informal) contractual arrangements, and its failure to base aggregative results firmly on consistent actions of economic agents at the micro-level, ignoring as a consequence incentive compatibility problems, issues of contract enforcement in a world of imperfect information, strategic interaction of agents (even with commonality of class interests), the free rider problem in class formation and action, and the disequilibrium dynamics of adjustment paths. Neoclassical economics has, of course, made substantial contributions in

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[32] Chenery (1975) already suggested that the differences between these approaches are relatively narrow when it comes to specifying the alternative empirically testable hypotheses.

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the goals of development, ignoring ways of expanding human capabilities beyond improvements on the technological frontier. Both sides are also prone to claim too much, in the generality of laws of motion of history (as in the case of Marxists) or of the supposedly universalistic postulates of human behaviour (as in the case of neoclassicals), overlooking important historical specificities and localized contexts of culture and ecology.

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