ECONOMIC DEVELOPMENT

THE HISTORY OF AN IDEA

H. W. Arndt

The University of Chicago Press
Chicago and London

article with this title and a more popular lecture, "The International Development of Economically Backward Areas,"[208] may well be regarded as the beginning of modern development economics.

3

Development as Growth (1945–1965)

When World War II ended, there was a well-established consensus among official and articulate public opinion in Western countries on the need to do something about the "urgent problems of economic development of underdeveloped countries."[1] Some were prepared to go so far as to declare that "the development of the less advanced countries may be regarded as the major need of the decades following the war."[2]

In the first few postwar years, thinking aloud about economic development was largely confined to the United Nations and other international organisations. But from 1949 onwards, a huge literature began to pour forth, some of the earliest contributions coming from economists such as Singer, Rosenstein-Rodan, Nurkse, Prebisch, Myrdal, and Lewis, who as experts in and for these international organisations had tried to come to grips with some of the problems. Their books and articles, and some by public men in the less developed countries themselves, crystallised what, for the next decade or two, became the conventional wisdom on economic development.

The reasons why the economic development of less developed countries, which had hardly received a passing thought at the end of World War I, was almost universally acknowledged as a major national and international policy objective at the end of World War II are not difficult to identify. The war had changed the balance of world power. The former colonial powers emerged greatly weakened, the national independence movements greatly strengthened. The ascendancy of the Soviet Union and the consequent spread of communist influence gave the less developed countries the status of a Third World progressively able to take advantage of the Cold War between the superpowers to press their demands. In the

West, the exigencies of power were reinforced by the commitment of influential public opinion to liberal and humanitarian principles which found colonial rules and the glaring contrast between life in rich and poor countries no longer acceptable. As the first economic textbook to treat the subject, P. T. Ellsworth's *The International Economy*, put it, "one of the outstanding social trends in the past twenty years or more has been mounting unrest in the economically backward nations of the world. Its principal manifestation has taken the form of an increasingly insistent demand for economic development to improve the lot of these less fortunate countries."[3]

"To improve the lot." In the most general terms, there was little doubt in anyone's mind about the meaning and purpose of economic development. In the words of an early postwar ILO document, "the improvement of standards of living is to be regarded as the principal objective in the planning of economic development."[4] Raising living standards could mean many different things. It could be interpreted as an all-encompassing objective, as when Myrdal said that "development means improvement of the host of undesirable conditions in the social system that have perpetuated underdevelopment."[5] Or it could focus specifically on the poor, as in an Indian official statement of 1947: "The main objective of the National Planning Committee was to ensure an adequate standard of living for the people and to overcome the appalling poverty and illiteracy of the masses."[6] Frequently, especially but not only in Latin America, economic development was still equated with industrialisation; Rosenstein-Rodan's 1943 article, for example, referred to problems of industrialisation, not economic development; of the countries of Eastern Europe.[7]

But economists soon sharpened and narrowed the interpretation. From a proclamation that the "ultimate *aim* in economic development is to raise the national welfare of the entire population[8] and the explanation that "essentially the *problem* of economic development is that of raising the level of national income through increased per capita output so that each individual will be able to consume more,"[9] it was only a step or two to speak of "the *definition* of economic development as a rise in the levels of living of the common people"[10] or

to say, more precisely, that "'economic development' may be defined as a sustained, secular improvement in material well-being . . . reflected in an increasing flow of goods and services"[11] or, still more technically, to "define economic development as the process by which an economy is transformed from one whose rate of growth of per capita income is small or negative to one in which a significant self-sustained increase of per capita income is a permanent long-run feature."[12] From about 1950 and through most of the next two decades, this interpretation dominated the literature, so that economic development was often virtually equated with economic growth, although the former term tended to be used mainly for poor, the latter for rich countries. When W. A. Lewis in 1955 published the first comprehensive book on economic development in all its aspects he called it *The Theory of Economic Growth* and nobody at the time seems to have thought this odd.[13]

In recent years it has become fashionable to scoff at this narrowly economic notion of economic development. It is therefore worth pointing out that, at least as a sort of shorthand, the notion made a good deal of sense and that few serious writers about economic development employed it without emphatic qualification.

People were unquestionably concerned to raise material living standards in the less developed countries, and economists had in the previous decade or two learned for the first time how, in however rough a fashion, to measure material living standards statistically. As Hicks had explained, "when the national income has been converted into real terms . . . it provides us with the best single measure of the nation's economic well-being, or economic progress, which we are likely to be able to get," although, as he had hastened to add, "of course no single measure can tell us all we should like to know."[14] Colin Clark, as we noted before, had published international comparisons of real per capita income which for the first time indicated the magnitude of the gap in material living standards between rich and poor countries. In the early postwar years, the United Nations secretariat prepared such estimates from official national statistics and used these figures to illustrate the magnitude of the problem of underdevelopment.[15]

Even if full weight was given to the inadequacy of per capita income as a measure of living standards, there was a more fundamental case for treating growth of real GNP as an essential ingredient; a necessary if not a sufficient condition, of economic development. "There is basically only one way in which 'all the men in all the lands' can approach freedom from want, namely, through vastly increased production. It cannot be too often repeated that improvement in living standards depends fundamentally on improvement in the capacity of a people to produce," particularly in contrast to prevailing popular notions that "steadier use of existing productive capacity and more even distribution of its fruits would yield fairly satisfactory living standards."[16] In this sense, it was not unreasonable to think of economic development as primarily "a combination of methods by which the capacity of a people to produce (and hence to consume) may be increased."[17] In the same spirit, Singer, in one of the first expositions of his views on economic development, insisted that "the important thing now must be to raise national income, to raise the level of resources, as quickly as possible."[18]

In Western countries, the tendency to think about economic development mainly as economic growth was undoubtedly strengthened by the fact that in the postwar decade economic growth became a major objective of economic policy in the developed countries and a major interest of economic theorists.[19] There was therefore a tendency to approach the study of problems of economic development with the toolkit designed by economists for the analysis of economic growth in advanced countries. The very fact that economists had a theory, or theories, of economic growth seemed to give them a head start over other social scientists as experts on economic development.

Even with all these reasons for thinking about economic development as chiefly a matter of economic growth, there was hardly an economist writing about economic development who did not go out of his way to warn his readers that economic development "means more than growth in national product."[20] Some emphasised change in economic structure, particularly "a relative shrinkage of the agricultural sector,"[21]

or change in social structure[22] as essential ingredients of the process of economic development. Others stressed that "growth, if associated with an increasing inequality in the distribution of income, is consistent with an increase both in the absolute numbers and in the percentage of the total population which is living in squalid and diseased poverty."[23] "Raising per capita income is not enough. . . . Unless the higher income per capita means a higher standard of living for the majority of people, . . . the result will only be to widen the gap between the rich minority who have grown richer and the poor majority."[24] The United Nations Economic and Social Council at its first session proclaimed the need for a long-term and balanced program of development which should include not only economic aspects but also "the social, scientific, health, educational and cultural aspects of community life."[25] Many made it clear that as economists they were focusing on but one aspect of a complex process which, under the name of modernisation, embraced among both its necessary conditions and its objectives profound changes in social attitudes. "Progress," Arthur Lewis argued more than once, "occurs only when people believe that man can, by conscious effort, master nature. . . . Even when people know that a greater abundance of goods and services is possible, they may not consider it worth the effort. Lack of interest in material things may be due to the prevalence of an other-worldly philosophy which discourages material wants."[26] The objective, said Myrdal, is much more than higher material living standards; it is "new men," "modern men."[27]

Nonetheless, until around 1960, these tended to be qualifications of the central theme of the economic development literature. The touchstone, if not the essence, of economic development was taken to be growth in output and income per head in the less developed countries. There were, even among Western economists, some who right from the start were highly sceptical about this whole approach to economic development. But the consideration of the views of these critics is best deferred to chapter 6.

Most of the literature, of course, was about means rather than ends, about the economics of development, and that is not what I am concerned with in this study. But the division between means and ends is never clear-cut. Ends determine means and means colour ends. The main strands in thinking about development *economics* are therefore of some relevance because they influenced the way people conceived the development *objective*. In the rest of this chapter, I shall describe the three main strands which can be identified during the period when economic development was very largely equated with economic growth. The first stressed capital formation as the most important factor, the second sought to correct this emphasis by stressing the importance of human capital, the third revived interest in trade as the engine of growth.

Capital Formation

The cornerstone of modern development economics in its first phase was capital formation. Nurkse was expressing a very generally accepted view when he said in 1952 that "this subject lies at the very centre of the problem of development in economically backward countries."[28] He, like others, was careful to add that capital formation is not the whole story. "Economic development has much to do with human achievements, social attitudes, political conditions—and historical accidents." Capital alone is not enough. But it is "a necessary condition of progress."[29] Arthur Lewis, in a famous passage, pointed to the saving rate as the key difference between an underdeveloped and a developed country: "The countries which are now relatively developed have at some time in the past gone through a rapid acceleration in the course of which their rate of net investment has moved from 5 per cent [of national income] or less to 12 per cent or more. . . . The central problem in the theory of economic growth is to understand the process by which a community is converted from being a 5 per cent to a 12 per cent saver."[30]

There is nothing surprising about this starting point. If economic development is mainly a matter of economic growth it obviously requires "diversion of a part of society's currently available resources to the purpose of increasing the stock of capital so as to make possible an expansion of consumable

output in future."[31] This had been the centrepiece of classical economics, from *The Wealth of Nations* to *Das Kapital*, and it had recently again become central to the growth theory which Harrod and Domar devised by dynamising Keynes.[32] Harrod and Domar were initially concerned, like Keynes, with the problem of full employment and went beyond Keynes only in extending his analysis to a growing economy. But their caricature of a dynamic economy in which the rate of capital formation is the only determinant of economic growth became enormously influential in the early years of postwar development economics. From this perspective, the most elementary fact about the less developed countries was that they were "capital hungry."[33] "A shortage of capital is almost by definition a characteristic of underdeveloped areas."[34]

One of the first purposes to which the Harrod-Domar approach was applied was to estimate the "capital requirements" of less developed countries. The United Nations group of experts, which reported in 1951 on this subject in *Measures for the Economic Development of Underdeveloped Countries*, concluded, on the basis of a little model devised by Singer,[35] that the capital required by underdeveloped areas each year to raise their national income per capita by 2 percent annually was about (1949) $US20 billion.[36] Before long, incremental capital/output ratios became a standard tool of development planners. "The first question in development planning is, 'How much total investment is needed to produce target increases in per capita income?' Answering this question requires determining the . . . incremental capital output ratio (ICOR)."[37]

The UN experts were interested in the capital requirements of underdeveloped areas chiefly because they had been asked to recommend measures requiring international action, and one of these clearly was the provision of external capital by rich to poor countries, through loans, aid, and private investment. Their estimate was that domestic saving in the underdeveloped areas could supply just over $US5 billion towards the total annual requirement of $US20 billion, leaving a deficit of about $US15 billion to be filled from abroad. While the UN experts and many others[38] were undoubtedly motivated by the needs of the poor countries, others had for some time been advocating large-scale capital exports from the rich to the poor countries for another reason, or had at least, like Sun Yat-sen a generation earlier,[39] been using it as a selling point for aid, and that was the contribution which such capital exports could make to the maintenance of full employment in the developed countries.

Some explicitly referred back to Sun Yat-sen. "The conjuncture of overcapacity in the industrial countries and industrial needs in the backward countries offered an opportunity after the last war. The great leader of the Chinese Revolution, Dr. Sun Yat-Sen, . . . offered the needs of China as a solution for the industrial problems of the West. . . . The practical suggestions . . . were not very convincing. Its fundamental thesis remains sound."[40] The Chinese delegate to an early session of the UN's Economic and Social Council (ECOSOC) was probably under the same influence when he said that the development of the underindustrialised countries is not only one of the most important economic questions in the world but "also gives us the clue to the solution of the problems of stability and full employment in the industrialized countries."[41] Others argued simply that "a vigorous development program for underdeveloped areas will yield markets both in the United States and Western Europe"[42] or referred to "the double object of raising standards of living in underdeveloped areas and furnishing new outlets for the productive capacity of existing industrial countries."[43] How strongly the Keynes-Hansen stagnation thesis dominated thinking in the early postwar years is illustrated by a remarkable outburst by the distinguished economist Oscar Lange, who represented Poland at the ECOSOC meeting just referred to. Protesting that the policy of restoration of the productive capacity of West Germany must inevitably fail, he argued that, "in the absence of an adequate demand from eastern Europe, the industrial products and export surplus of western Europe, and particularly Germany, will prove unmarketable. The countries of western Europe are industrially competitive rather than complementary. Where will they—and again, expecially, where will Germany—export their surplus? To Latin America, in competition with the United States? To the British Common-

wealth, in competition with the United Kingdom? Or to the Middle East?"[44] In the following years, as fears of a postwar depression and stagnation receded, this argument also lost favour. But for a time it almost certainly reinforced the emphasis on capital formation as the key to economic development.

Finally, some weight must be given to the tendency in the early years to think of economic development as virtually synonymous with industrialisation; indeed, as we noted before, it was only towards the end of World War II that the term "economic development" replaced "industrialisation" in general usage. The reasons are fairly obvious. Industrialisation had been the most conspicuous feature of capitalist economic development in the now developed or industrialised countries and had more recently been the chief ingredient in Soviet development under Lenin and Stalin. As an objective, industrialisation implied urbanisation with its connotation of modern urban civilisation. The vulnerability of primary exporting countries during depression and war had, especially in Latin America, given an impetus to demands for industrialisation as a means of economic diversification. Whatever the motives, industrialisation required fixed capital—factories, plant and equipment; and if it also required technical knowledge, "an advance in technical knowledge may be of no economic relevance if there is no capital in which to incorporate it."[45]

The emphasis on capital formation, in turn, was embedded in a wider ideological setting which coloured almost all thinking about economic development in the early postwar years, in the Western literature as much as in the less developed countries themselves, and to which some reference must be made.

Economic development could not be left to market force. It had to be planned. To the nationalist leaders in India and other colonial territories this seemed an obvious inference from the legacy of underdevelopment which they associated with laissez-faire or imperialist colonial rule. To many of them, the Soviet example underlined the inference and pointed the way. Five-year plans became the order of the day, some of them, such as India's second plan, consciously inspired by the Soviet model. But in the West, too, following the debacle of the Great

Depression and the apparent successes of economic planning for war, economic liberalism was on the defensive. Under Keynesian-Fabian influence, governments assumed responsibility for full employment and social welfare and increasingly, as economic growth became the prime objective, planning for growth came to seem imperative.[46] In this intellectual climate it was an easy step from recognition of a problem to demand for government action, from acceptance of the urgency of economic development to the conclusion that economic development must be planned. Here, too, at least in the warm glow of the wartime alliance, the Soviet model was influential. "Only once in modern times has there been any attempt on the part of a great state to solve problems of such magnitude, namely, the Russian Revolution. . . . Collective planning can now be regarded as a key concept."[47]

Very soon Western economists concerned with economic development devised neat formulations of the need for government intervention. The intellectual foundations for most of this development–planning literature were laid by Rosenstein-Rodan in his 1943 article. In one sweep, following the clue provided by Allyn Young in his dynamic interpretation of Adam Smith's dictum that "the division of labour depends on the size of the market," he rested the case for "planned industrialisation" on a Pigovian divergence between the social and private marginal product arising from "external economies" on the side of demand and argued for a "big push" aimed at internalising these external economies through "balanced growth," i.e., investment on a broad front of industries, which would put the "agrarian excess population" to work through a massive inflow of foreign capital.[48] In the years around 1950, Singer, Nurkse, Myrdal, and others developed and spelled out these ideas.

Singer, in a short article, brought together and expressed in vivid language almost all the themes of what was to be the dominant school of thought on economic development in the next decade. There were epigrams about the "vicious circle" of underdevelopment. "An underdeveloped country is poor . . . because it is poor." "One thing leads to another, but nothing leads to nothing."[49] The way to break out of this

vicious circle was a big push aimed at "multiple development."[50] "What is needed is a big initial effort to carry through the barren period due to increasing returns and long gestation periods."[51] Singer also stressed the importance of external economies but, in contrast to Rosenstein-Rodan, "external economies in economic production, especially in the fields of transport and power," rather than on the side of demand.[52] Singer's idea that the vicious circle can become a "virtuous" circle and that "economic development is a cumulative process of this kind"[53] was taken up by Myrdal, who expounded the "hypothesis of circular cumulative causation" as "the principle upon which an underdeveloped country can hope to 'lift itself by the shoe strings,' if only it can manage to accomplish what Professor W. W. Rostow calls the 'take-off into self-sustained growth'."[54] Nurkse, for his part, spelled out Rosenstein-Rodan's idea of "balanced growth" and developed his notion of "agrarian excess population" into "the saving potential concealed in rural unemployment."[55]

It would be quite wrong to suggest that these ideas, of what might be called the orthodoxy of the first phase of postwar thinking about economic development, were universally accepted, even among the rapidly growing development profession, let alone by practical men, administrators, or revolutionaries. The authors who put the ideas forward themselves qualified them, and others, even among those who viewed economic development (primarily) as economic growth, questioned them. Thus Singer would say that it is "true, although only partially true, that underdeveloped countries are poor because of a lack of capital,"[56] a qualification which Condliffe had made more emphatically some years earlier—"capital is not the sole or even the main need of underdeveloped countries, . . . their primary need is skilled administrators and technicians"[57]—and which was repeated again and again.[58] The whole Harrod-Domar approach soon ran into damaging criticism.[59] Buchanan and others questioned the usefulness of estimates of "capital requirements,"[60] Viner and others the overemphasis on industrialisation.[61] The doctrine of "balanced growth" was soon criticised on several grounds, by Fleming because it neglected complementary inputs in inelastic supply in underdeveloped countries,[62] by Hla Myint because it neglected international trade,[63] and by Hirschman because it neglected the importance of "strategic imbalances" needed to induce investment in a dynamic economy.[64]

Indeed, so quickly did the literature on economic development proliferate that there are few points of any substance about economic development which cannot be found, persuasively argued, in books, articles, or reports written in the first ten years after the end of World War II. Nonetheless, there can be little doubt that, during those years and at least until the end of the 1950s, the themes discussed in this section, capital formation and the associated concepts of planned industrialisation, big push, and balanced growth, dominated the discussion. It was around 1960 that the emphasis began perceptibly to change.

Human Capital

In 1959, the first edition of one of the best-known textbooks of development economics still insisted that "capital accumulation is the very core of economic development."[65] Two years later, H. W. Singer told a conference in Addis Ababa that there had been "a shift in our whole thinking about the problem of growth and development"—from physical to human capital. "The fundamental problem is no longer considered to be the creation of wealth, but rather the *capacity* to create wealth," and this capacity resides in the people of a country. "It consists of *brain power*."[66]

The shift of thinking to human capital, which occurred in just two or three years around 1960, had its origins in the then current preoccupation with economic growth and its causes in developed countries. But it was quickly taken up by those who were writing about economic development. One result was to revive the somewhat dormant interest in technical assistance, as contrasted with capital aid, to developing countries; another was to introduce new themes—investment in education, manpower planning, the "brain drain"—into the development literature.

The Residual Factor

In the first modern survey of what economists have to say about economic growth, Abramovitz wrote in 1951 that "it is probably safe to say that only the discovery and exploitation of new knowledge rivals capital formation as a cause of economic progress." But about the relative magnitude of the contribution to growth of advances in knowledge he was agnostic. "While it is clear enough in a general way that technical improvement leads to increases in output, and while we may be confident that, directly and indirectly, a very large share, if not the bulk, of the increase in output is to be attributed to advances in knowledge, measurement of the relation between changes in the stock of knowledge and the pace of economic growth has so far proved impossible."[67]

In the next few years, he and others, including Fabricant, Solow, Kendrick, and Denison, tackled this problem.[68] A succession of empirical studies of the aggregate production function, first for the United States and then also for other industrial countries, all agreed on one conclusion: the proportion of the increase in GNP that could be attributed to measurable inputs of capital and labour was much smaller than had been expected. If, as these studies suggested, the contribution of inputs of capital and labour explained only 10-20 percent of secular growth of total output,[69] the explanation of economic growth, and of differences in the rate of economic growth among different countries, had to be sought in the "residual factor"[70] which tended to be equated with technical progress or, more generally, advances in knowledge, including those resulting from education.

Subsequent discussion of the problem suggested that there were no simple answers. "The critics have argued that what is called technical progress may not be technical progress at all, let alone advances in knowledge, but the result of (a) substitution of capital for labour, (b) economies of scale, (c) learning by experience, (d) increased education, (e) resource shifts, and (f) organisational improvements, plus (or minus) any errors in the measurement of the variables."[71] Indeed, as the editor of a symposium on the subject wistfully asked: "Is the 'residual factor' a measure of the contribution of knowledge or is it simply a measure of our ignorance of the causes of economic growth?"[72] The immediate effect of this debate, however, was to focus interest on human capital as a factor in economic growth.

The man who, almost single-handedly, introduced this concept into economics was T. W. Schultz. He has explained how this happened. "My own interest in this field took shape during 1956–57. I had been puzzled by the fact that the concepts I was using to measure capital and labour were close to being empty in explaining the increase in production that occurred over time. . . . I began to see that the productive essences of what I was identifying as capital and labor were not constant but were being improved over time and that these improvements were being left out in what I was measuring as capital and labor. It became clear to me also that in the United States many people were investing heavily in themselves as human agents, that these investments in man are having a pervasive influence upon economic growth and that the key investment in human capital is education."[73] In the early 1960s, Schultz, Becker, and others developed the concept of investment in human capital and its implications.[74] One effect, reinforced by temporary alarums in Western countries related to rising costs of education and an apparent shortage of certain kinds of skill, was the creation of a virtually new branch of the discipline, economics of education.[75] It is hardly surprising that these ideas quickly spilled over from thinking about economic growth in the industrial countries to thinking about economic development in the Third World.

Technical Assistance

Shortage of skills, as well as of capital, as an obstacle to economic development had, of course, been a theme in the development literature from its beginnings. The United Nations experts of 1951 were not saying anything very new when they began their chapter on technology by pointing out that "one of the most striking features of underdeveloped countries is their low level of technology. . . . As a result of the

remarkable progress in science during the past two hundred years, the gap in technology between the developed and the underdeveloped countries has grown wider and wider."[76] The experts shared the then widely current optimism that this very gap held out a promise: "If the obstacles to the absorption of new technology are overcome, the existence of highly productive methods and processes, which do not have to be discovered anew, but are available for transmission and appropriation, lays open wide opportunities for the underdeveloped countries to profit from experience later gained. . . . They may be able to achieve a rapid advance."[77] But they also warned that absorption of new technology is a difficult and costly process, that it needs well-developed administration, experts and technicians, literacy and educational institutions.[78] It was the idea that the more developed countries could help remedy the shortage of skills of the less developed that had provided the rationale for the early postwar enthusiasm for technical assistance.

The impetus for this assistance had come suddenly and almost fortuitously with President Truman's "Point Four." Some provision of experts and training facilities had for some time played a part in British, French, and other colonial policies and had been initiated by the United States in January 1940 when the Inter-American Development Commission was established to promote "commercial, cultural, educational, and scientific aspects of Hemisphere defense relations."[79] One of the first resolutions of the UN General Assembly relating to underdeveloped countries had noted that "some were in need of expert advice on methods of meeting the requirements connected with economic development"[80] and much of the work of the new specialised agencies of the United Nations, UNRRA, UNICEF, and later the FAO, had consisted of technical assistance in various forms. But this had been on a modest scale. Large-scale technical assistance, bilateral and multilateral, began when President Truman proclaimed, as Point Four in his inaugural address of 20 January 1949, "a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas."[81]

The origins of Point Four, as one of the administrators of the program later conceded, are "murky."[82] In his memoirs, President Truman explained them very simply. "The Point Four program was a practical expression of our attitude toward the countries threatened by Communist domination."[83] But while the Cold War was an important motive for a more vigorous US program of development assistance, there were other reasons for the particular emphasis on technical assistance. Partly for Cold War reasons, the United States was according priority to postwar reconstruction in Europe. The Marshall Plan was preempting resources for capital aid. Washington was under pressure, especially from Latin America, for more generous assistance. Technical assistance was relatively cheap. "There are many aspects of development in which much can be accomplished through technical aid requiring relatively small expenditures for supplies and equipment."[84] As Truman explained: "The material resources which we can afford to use for the assistance of other people are limited. But our imponderable resources in technical knowledge are constantly growing and are inexhaustible."[85] But Truman also reflected a widely shared conviction that "greater production is the key to prosperity and peace. And the key to greater production is a wider and more vigorous application of modern scientific and technical knowledge.[86] Perhaps because of this faith in the power of science and technology, Point Four marked, to a degree that is not easily remembered, the peak of optimism about what development assistance could do. "Prospect of an expanded program of technical assistance fired the imagination and evoked the enthusiasm not only of government officials but of peoples as well."[87]

Point Four had not only launched a new US program for technical assistance to developing countries but had also within a few months induced the United Nations to coordinate and widen its own operations and those of the specialised agencies in an Expanded Program of Technical Assistance[88] and stimulated bilateral programs such as the Colombo Plan of the British Commonwealth countries, which had a large technical assistance component.[89] These programs continued and indeed expanded during the 1950s but the early enthusiasm

quickly waned; technical assistance was increasingly overshadowed by capital aid. One reason was the priority accorded to capital formation as a source of growth. "With developers preoccupied by capital flow problems, technical assistance suffered more from neglect . . . than from outright opposition."[90] But it also became increasingly evident that the developing countries generally preferred money to advice and that technical assistance was much more difficult than had initially been realised. "Everywhere the adoption of new methods encountered difficulties rooted in local culture and tradition."[91] "As it turned out, the task was much more complicated. The teaching of technology, by itself, is the easiest part. What is infinitely more difficult is identifying what knowledge is relevant, and fitting its use into existing systems of human effort."[92] By the end of the decade, it became fashionable to address issues such as "Why Visiting Economists Fail."[93] The conclusion seemed inescapable that "the optimism which prevailed when President Truman devised point 4 was mistaken. It is not enough to send highly skilled people to developing countries as experts and hope for quick results, if these experts are bringing techniques which have only proved to be economically effective in economically advanced countries. Technical assistance is a long-term task."[94]

It was at this juncture that the new ideas about human capital and education as investment in man revived interest in technical assistance, but with a new orientation. Singer was quick to point the moral. "The educational deficiencies of underdeveloped countries can, in the short run, be dealt with by measures [such as] . . . the employment of foreign experts and technicians. . . . [But transfer of existing technology by means of] technical assistance . . . is not the fundamental solution." What is needed is a different kind of technical assistance, "to assist underdeveloped countries in making their own type of investment in human capital and in research and development."[95] Soon this distinction was made more explicit. "The function of technical assistance and other forms of human resources is twofold. It can help fill gaps between the skill requirements implicit in development programmes and the domestic stock of skills. But it is also needed to strengthen and supplement a country's capacity to produce new skills via its education system."[96]

During the early 1960s, a spate of conferences, books, and reports developed this reorientation of technical assistance.[97] The emphasis in training shifted from scholarships to Western universities, with the attendant dangers of alienation, to "institution-building" in the developing countries themselves.[98] In line with the reformulation of the purpose of development assistance that inspired the Kennedy program "aid to end aid,"[99] technical assistance, especially in the field of education and training, came to be presented as a matter of "helping people to help themselves."[100]

How much difference all this made to the character and effectiveness of the whole technical assistance effort is not easy to judge. Technical assistance has continued to be of both kinds, short-term and long-term, experts and training. Institution building as a form of technical assistance has proved to be so much more expensive and difficult, if in the long run more rewarding, that it has supplemented rather than replaced the two older kinds, supply of experts and overseas training facilities. "The complexity of the undertaking"[101] has come to be more fully recognised, with enough successes or passable results mixed in with failures and disappointments to ensure that the whole process, buttressed by vested interests in donor and recipient bureaucracies, continues unabated.

Manpower Planning

The suddenly heightened interest around 1960 in human capital as a factor in economic growth and development happened to coincide with the peak of enthusiasm for economic planning, "indicative planning" on the French model in Western countries and five-year plans influenced in varying degree by the Soviet example in developing countries.[102] The result was a vogue for manpower planning.

Centralised planning in the Soviet Union depended on "material balancing," matching supply and demand of physical quantities of inputs and outputs. Matching future supply and demand of categories of labour with different skills fitted

naturally into this pattern, and Soviet planners had unquestionably been successful in vastly increasing the country's supply of scientific and technical manpower. Inspired by the Soviet example, the chief authors of the second and third five-year plans in India, Mahalanobis and Pitambar Pant, launched ambitious programs of manpower planning for India, including "special studies of the requirements for engineers, agricultural specialists, chemists, physicists, geologists, geophysicists, doctors, etc. in India."[103] In the early 1960s, the idea was taken up by international organisations and in many developing countries.[104] Optimists entertained "the notion that it is possible to ascertain the optimum amount of education for achieving specified growth targets."[105] Forecasting of manpower requirements, in turn, was viewed as the starting point for education planning. "In making projections of the needs for skilled manpower of all sorts, it has been possible to calculate back into the education system the number of educated people required to produce the necessary skills."[106]

Within a few years, some of the more extreme pretensions of the manpower planners came under critical scrutiny. Economists questioned their engineering approach, evincing "a dual scepticism, first of long-period forecasts . . . and, secondly, of a notion that an economic concept of 'shortage' can manifest itself without the classic economic indications, of which a rising price is the surest."[107] "There is a tendency to talk of the 'needs' for development as if they were quite independent of the actual structure of job opportunities in the economy. . . . Cumulative errors in the projections of a whole range of manpower needs can ultimately add up to an alarming misallocation of scarce resources."[108] The importance attached to education could be overdone. "To attribute all improvements in productivity to education would therefore be more than a little naive."[109]

Part of the difficulty in developing countries is that "the education system produces the wrong kinds of education."[110] But there was no universal consensus about the right kinds. The predominant view was that the emphasis had to be on the "formation of scientists and engineers."[111] Others, seeing the basic causes of underdevelopment in the attitudes and motivations of traditional cultures, took a different view. "Logically, one might perhaps expect a great upsurge of a liberal education policy encouraging individualism, enterprise and innovations to break down the rigidities both of the traditional and of the colonial systems."[112] By the end of the 1960s, the potentialities of manpower and education planning had come to be seen in more sober perspective. "Forecasting is necessary and must be done."[113] But unless the demand for each kind of skill is wholly under centralised control, as in a socialist command economy, even imperfect market signals may be a better guide to supply than long-term forecasts by planners.

Brain Drain

Another by-product of the emphasis on the importance and shortage of skills was concern about "brain drain." The first rumblings were heard around 1960 when Nehru called attention to the number of Indian scientists who had settled abroad and when the Shah of Iran appealed to Iranian students to return from abroad.[114] In 1961, Brinley Thomas, in the context of a broader study of international factor movements and economic growth, referred to the "two-way traffic of skilled personnel between the poorest and the richest countries. On the one hand, we find a 'perverse' emigration of trained people from the countries in the lowest income bracket to the advanced countries; on the other hand, there is the reverse movement of experts financed out of public funds." He warned that "under a regime of *laisser faire laisser passer* the transfer of skilled personnel from poor to rich countries could be on such a scale that the former could never begin the process of economic growth" and called for "measures . . . to protect and increase [their] supplies of skills."[115]

In the following years, particularly after relaxation of US immigration restrictions in 1962, which helped to swell the flow of engineers, doctors, and other professionals to the United States,[116] the subject was widely debated, not least in developed countries which were losing trained people to the United States—the phrase "brain drain" was coined in Britain[117]—but the debate helped to put the problem in better perspective and thus fairly quickly ran its course.

That the brain drain was harming the countries of emigration, if only through loss of taxation costs of educational investment, was admitted even by the most sternly neoclassical "internationalists" in the debate.[118] They tended to suggest, not very helpfully, that less developed countries (LDCs) should stem the outflow by paying their doctors higher salaries and impose an obligation on those who nonetheless emigrated (or on their foreign employers) to repay to the home country the cost of their education.[119] On the other side were the "nationalists," who were not content to view the problem in terms of a "world social welfare function" and insisted on the right to view it from the point of view of the national interests of the "brain-losing" countries.[120] They were supported by some of those involved in formulating and administering foreign aid policies who saw a conflict "between our efforts to train people in the less developed countries and our drain of foreign specialists to fill important jobs here in the United States."[121] But even these were, generally, not prepared to suggest that the outflow should be stopped by iron or bamboo curtains and had little more to offer by way of remedies than advice to the LDCs to "deal with the problem by persuasion, appeals to a sense of patriotic responsibility, and making the necessary adjustments in their social and economic structure."[122]

This last piece of advice presumably referred to the widely held view that outflow from some of the LDCs largely reflected domestic imbalance between supply and demand for skilled manpower, or an excess supply of graduates relative to effective demand at the levels of income expected by graduates whose primary objective was "the 'middle class' standard of living associated with the educated elite in the past."[123] Such imbalance seemed unlikely to persist indefinitely under the pressure of market forces. Similarly, the belief that "the United States as a mature but still growing nation has an apparently unlimited demand for" LDC doctors and engineers[124] which inspired some of the more extreme fears about the magnitude of the brain-drain problem proved unrealistic. As excess demand for many kinds of highly skilled manpower gave way to excess supply after years of rapid university expansion and with the slowdown of economic growth, the pull effect diminished. By the end of the 1960s, there was fairly general agreement with Myint's conclusion that "whatever our views on the welfare aspects of the brain drain, its effect on the retardation of the economic development of the underdeveloped countries is less alarming than it appears at first sight."[125]

Conclusion

Those who in the 1960s insisted on the importance of education for economic development interpreted the objective of economic development in terms not significantly different from those who in the previous decade had put the chief emphasis on physical capital formation. What they were concerned with was, in the words of a United Nations report, "the organization of education and training of the whole of the people as primary factors in the *economic growth* of the less developed countries."[126] They did not in any direct way challenge the prevailing orthodoxy which virtually equated economic development with growth of per capita income.

Indeed, it is arguable that they did not even challenge the primacy of capital formation among the means to economic development. The central contribution of the Chicago economists, Schultz and Becker, was to identify education as a factor in economic growth precisely *because* it is a form of capital formation. As the argument was put by R. B. Goode, perhaps even a little before Schultz, "it is generally agreed that capital formation is one of the principal requisites of economic progress. . . . Although Adam Smith included in a country's stock of fixed capital 'the acquired and useful abilities of all the inhabitants,' most economists have given little attention to human capital." The acquisition of human, as much as of physical, capital involves an economic cost and promise of future return. He therefore proposed to widen the definition of capital formation: "Investment or capital formation is

taken to consist of the devotion of resources to making additions to the stock of physical and human capital."[127]

Once this step was taken, it followed naturally that education could be thought of as "investment in man" and that it should be possible to estimate the "economic value of education" interpreted as the rate of return on investment in man.[128] H. G. Johnson merely dotted the i's and crossed the t's when he proposed the idea of thinking of "development as a generalised process of capital accumulation,"[129] where capital is defined as including anything that yields a stream of income over time, and income as the product of capital.[130] Johnson may or may not have been right in claiming that such a generalised concept would help restore some balance after a period of "exaggerated concentration" on human capital, with the prospect of "a rehabilitation of investment in material capital as a potent source of economic growth."[131] What matters in our context is that the shift of emphasis from physical to human capital did not, in itself, denote a change in the meaning given to the development objective. But this was a case—and we shall encounter more than one—where a change of emphasis about the means brought with it subtle changes in the way people thought about the ends.

Whereas expenditure on capital goods is investment pure and simple, expenditure on education is part investment, part consumption. Thus, though development economists were out "to suggest that some of the outlays for education could be considered as investment rather than simply current consumption or 'social' expenditures,"[132] the effect was to some extent the reverse. They came "to stress the general importance of education"[133] and it was hardly possible to think about education merely as investment aimed at economic growth. When Schultz wrote about the economic value of education, he thought it necessary to apologise for what must look "as an intrusion which can only debase the cultural purposes of education."[134] And when Harbison and Myers expounded the principles of manpower planning, they began by insisting that "it is incorrect to assume that the central purpose of human resource development is to maximize man's contribution to the creation of productive goods and services"[135] "As economists," they still thought, "we are first of all interested in economic growth." But their interest in education and manpower planning made them acutely conscious of the inadequacy of so narrow an interpretation of the development objective. "We are convinced that the worldwide aspiration for development is much more than a desire for economic progress. It is a quest as well for status, prestige, recognition, and social and political modernization."[136]

In these ways, the new emphasis on human capital, though explicitly wholly concerned with the promotion of economic development in the sense of economic growth, pointed towards the broader interpretations that were beginning to enter the development literature. But before we turn to these, we must deal with one more strand in thinking about development which was still firmly in the economic growth school.

Trade as the Engine of Growth

In December 1961, the United Nations General Assembly passed Resolution 1707, "International Trade as the Primary Instrument for Economic Development."[137] It was an event that few would have predicted ten years earlier and that still causes surprise in retrospect. How, after a decade and more during which capital formation, physical and human, had occupied the centre of the development stage, did trade come to be elevated to that position?

Import Substitution

Controversy about the future of international trade and commercial policy had been part of the discussion of postwar plans even before the end of World War II and the controversy continued into the postwar years. There was argument for and against the view expressed in the late 1930s by D. H. Robertson that, for various reasons, international trade was unlikely in the twentieth century to play the role of "an engine of growth," which it played in the nineteenth.[138] Official US

policy spokesmen, supported by economists such as Jacob Viner, pleaded and campaigned for a liberal trading system, removal of trade barriers, and the principle of nondiscrimination.[139] In Britain, official policy was more ambivalent, and there were those who drew the lesson from the interwar years that henceforth "there will have to be direct planning of international economic intercourse . . . there is much to be said for superseding the free play of market forces."[140] The dispute was partly a revival of the nineteenth-century argument about free trade and protection. Even more so, it was part of the wider ideological debate between advocates of a market economy and of planning or, more crudely, of capitalism and socialism.

During the first postwar decade, the literature on the economic development of less developed countries, insofar as it concerned itself with international trade and commercial policy, was dominated by critics of free trade. Ragnar Nurkse applied D. H. Robertson's trade pessimism to developing countries, arguing that "the tremendous expansion of Western Europe's and especially Great Britain's demand for foodstuffs and raw materials" which had provided "the basic inducement that caused them [especially the United States, Canada, Argentina, and Australia] to develop" could not be expected to function as the engine of growth for the still underdeveloped countries of the Third World. He therefore advocated balanced growth.[141] A school arose, represented most prominently by Raul Prebisch and Gunnar Myrdal, each an executive secretary of a United Nations economic commission (Prebisch for the Latin American and Myrdal for the European), who rejected the classical theory of international trade as inapplicable to less developed countries and argued that, far from acting as an engine of economic growth, international trade had been responsible for hindering development. In a programmatic study of "Growth, Disequilibrium, and Disparities: Interpretation of the Process of Economic Development" (1949), which was to become extremely influential, Prebisch argued that the growth of the West "had left untouched the vast peripheral area with its enormous capacity for assimilating technical progress so as to raise the very inadequate standard of living of the great masses of its population." A major reason was that, because of inelastic world demand for primary products and a combination of monopolistic pricing of manufactures with competitive markets for primary commodities, "the periphery tends to transfer a part of the benefits accruing from its technical progress to the centres while these latter retain their own benefits for themselves."[142] This explained the secular decline in the terms of trade for primary products between the 1860s and 1930s which a United Nations study had recently documented. The Prebisch-Singer thesis,[143] about the declining terms of trade for primary products, despite seemingly conclusive refutations of both the empirical evidence and the theoretical explanation by a succession of economists, became, and has remained, a centrepiece of Third World ideology.[144]

Myrdal developed a more systematic theory of international trade as a mechanism of international inequality. "Contrary to what the equilibrium theory of international trade would seem to suggest, the play of market forces does not work towards equality in the remuneration to factors of production and, consequently, in incomes."[145] On the contrary, international trade strengthens the industrial countries while the underdeveloped countries find their traditional industry ruined by cheap imports, their skills impoverished. International trade has, it is true, stimulated the production of primary products, but these face inelastic demand and excessive price fluctuations and tend to be confined to plantations and mining enclaves, which do little to promote general economic development. "Under these circumstances the forces in the markets will in a cumulative way tend to cause ever greater international inequalities between countries as to their level of economic development and average national income *per capita*."[146] Nurkse summed up this view in his Wicksell lectures: "In a world in which (outside the Soviet area) over nine-tenths of the manufacturing and over four-fifths of the total productive activity are concentrated in the advanced industrial countries, the ideas of symmetry, reciprocity and mutual dependence which are associated with the traditional theory

of international trade are of rather questionable relevance to trade relations between the centre and the periphery."[147]

The chief policy inference for the underdeveloped countries drawn from this analysis was an urgent need for rapid industrialisation based on import substitution. Prebisch, in the 1949 ECLA study, stopped short of actually advocating such a policy, but the whole argument pointed towards it. "There is, in fact, a dynamic element in industry which is not found to a comparable extent in primary production." "The attempt to raise income in the Latin American countries by means of exports may run into serious difficulties caused by competition from other countries" and technical progress in agriculture, while necessary to raise rural incomes, inevitably creates a surplus of labour.[148] "Since there is no other way of absorbing the gainfully employed population and increasing its productivity, the activities which can be developed by protective tariffs do, within certain limits, give rise to an increase in real income."[149] Myrdal, while pointing out that wartime interruptions of supply and postwar balance of payments problems had led many LDCs to adopt import restrictions, argued strongly that LDCs "have quite a number of other sound reasons, based on their peculiar situation, for using these restrictions for protective purposes."[150] In line with the argument developed by Rosenstein-Rodan and Nurkse that a major obstacle to economic development is a Keynesian-type insufficiency of effective demand because the inducement to invest is limited by the size of the market,[151] Myrdal argued that "import restrictions afford a means . . . of creating at once the necessary demand for a particular domestic industry."[152]

A whole new literature of LDC protectionism grew up around new infant industry and "infant economy" arguments which found ammunition even in the writings of liberal economists, such as Lewis's case for compensating manufacturing industry for the high cost of labour set by average income in agriculture, and Hirschman's, based on the historical experience of the industrial countries, for infant industry protection until a "threshold" is reached.[153] The Soviet model of autarkic industrial development was influential, especially in India through the role of Mahalanobis, physicist turned planner, who "*implicitly* assumed a closed economy or a situation of stagnant export earnings through inelasticity of export demand."[154] Nurkse's balanced-growth model could be interpreted as having similar implications since, as a critic later pointed out, "there can be no specialisation for the home market."[155]

The new protectionism for LDCs was not without its critics. Western economists submitted the new arguments to scrutiny.[156] At the official level, the United States had failed in its early postwar efforts to establish an international trade organisation to monitor a liberal "charter" but had salvaged that part dealing with liberalisation of tariffs in the General Agreement on Tariffs and Trade. The GATT, through successive rounds of tariff negotiations, did much to liberalise trade in manufactures among industrial countries. Its efforts, and those of the Organisation for European Economic Cooperation (OEEC) (later the Organisation for Economic Cooperation and Development, OECD) which encouraged the removal of import restrictions and the liberalisation of trade within the two new regional groupings, the European Economic Community (EEC) and the European Free Trade Area (EFTA), made a substantial contribution to accelerating economic growth in the industrial countries during the 1950s and 1960s, but this liberalisation did not extend to trade in agricultural and other primary products. It was not seen as giving any direct help to developing countries—indeed many of their exports confronted new barriers erected by the EEC's Common Agricultural Policy—and did nothing to discourage their generally inward-looking policies.

The emergence during the 1950s of the notion that international trade might play a more positive role in economic development than the first generation of postwar development economists had assumed was due not to these Western protagonists of liberal trade policies. It derived from three other influences: concern about the "foreign exchange gap" of developing countries; growing disenchantment with the import-substitution strategy in Latin America and elsewhere; and Soviet efforts to neutralise the role of GATT, reinforced by the

emerging political muscle of the Third World. It was the partly fortuitous confluence of these three that led to the UN Assembly resolution of 1961 and ultimately to the first United Nations Conference on Trade and Development (UNCTAD I) of 1964.

Internationalisation of Protection

In 1957, the GATT appointed a group of economists under the chairmanship of Professor Haberler to report on "certain trends in international trade, in particular the failure of the trade of less developed countries to develop as rapidly as that of industrialised countries, excessive short-term flunctuations in prices of primary products, and widespread resort to agricultural protectionism."[157] These terms of reference reflected the special interests of Australia (which had taken the initiative for the appointment of the group) and a concern which had become increasingly prominent in discussion of the problems of developing countries in the preceding years, their "foreign exchange gap."

After the earlier phase when estimates of the capital requirements of LDCs had revealed major "saving gaps," economists were now making estimates of LDC import requirements, usually based on assumed target rates of economic growth together with fixed import coefficients. Uniformly, they revealed the prospect of "foreign exchange gaps" left by adverse prospects for LDC exports and inadequate aid by developed countries.[158] Of the two gaps, the foreign exchange gap appeared as the more serious constraint on economic development, as the LDCs with few exceptions struggled to meet chronic balance of payments difficulties through import and foreign exchange controls. In the theoretical literature this gave rise to "two gap analysis" (and debate about its analytical soundness); in practical policy discussion it led to the slogans "trade not aid" or "trade and aid."[159]

The Haberler Report picked up this theme. Its criticisms of the tariff and other barriers erected by developed countries, which it described as an important factor contributing to the foreign exchange difficulties of LDCs, led to the appointment by GATT of a standing committee—the famous Committee III—with the task of encouraging policies to help their exports. In passing, the report also commented adversely on LDC policies of import-substitution which "had almost certainly been to the disadvantage of the underdeveloped countries themselves."[160] But its recommendations were entirely addressed to exports of primary (and semiprocessed) commodities. Very soon, however, attention began to be directed to the need for freer access to developed-country markets for LDC manufactures. Wyndham-White, director-general of GATT, in June 1960, sounded a note that would become much more prominent two decades later: "It is difficult . . . to escape the conclusion that one of the contributions which the older industrialized countries will have to make will be to surrender some sectors of light manufacturing to new industries in the developing countries, finding their compensation in the more specialized and dynamic forms of industrial production on which their economic growth in any case depends."[161] A few months later, the UN Economic Commission for Europe published a study of "Europe and the Trade Needs of the Less Developed Countries," in which it argued that, since aid and exports of primary products would meet only two-thirds of the import requirements of the Third World in 1980, "this would leave the remaining one-third, i.e., at least $15 billion, to be filled by exports of manufactures" and on infant-industry grounds proposed the first scheme for a generalised system of preferences (GSP) for LDC manufactures, very much on the lines of the scheme later adopted by the EEC.[162]

Meanwhile, Prebisch himself had begun to have second thoughts about the merits of the import substitution strategy. The UN *Economic Survey of Latin America for 1956* expressed disappointment that import substitution appeared to be failing in two of its major objectives, saving of foreign exchange and thus reduced dependence on world markets. "Unbalanced development may involve a rapid growth of certain essential imports, so that, in the final analysis, the economy is as much as ever at the mercy of events overseas—or even more so. . . . This leaves an increase in the volume of exports as the only reliable source for the financing of the expanding volume of

imports."[163] While this suggested the need to pay more attention to exports, it did not at first induce any rethinking of industrial development strategy. "This leads to the rather paradoxical conclusion that the only way of financing the imports for growing secondary industries is to expand the volume of exports of primary products."[164] But two years later, while continuing to insist that import substitution was "the only way to correct the effects on peripheral growth of disparities in foreign trade elasticity,"[165] he began to advocate regional integration among LDCs—"preferential treatment is needed inside the area to promote specialisation in industrial products and primary commodities"[166]—and to argue for non-reciprocal tariff cuts by developed countries on imports from developing countries, as well as for measures to ensure more equitable and stable prices for primary commodities.[167]

Thus, intellectually, the stage was set for the UN resolution of December 1961 declaring international trade to be the primary instrument of economic development. But, politically, its adoption as a plank of the ideological platform of the Third World had different origins.

One front in the Cold War of the 1950s was that on which the two superpowers manoeuvred for the sympathy of the Third World. As GATT moved in 1956 to demonstrate its concern for the trade problems of the developing countries, the Soviet Union countered by proposing the holding of a world economic conference to discuss problems of trade and development;[168] with the support of other Soviet-bloc countries, it repeated this proposal for some years. As long as the proposal came from this source, it was not taken very seriously in the West. During the second half of the decade, however, with the sudden acceleration of decolonisation and the admission of numerous new member countries, voting strength in the United Nations General Assembly shifted,[169] and the bloc of seventy-seven "nonaligned" countries, which had emerged from the Bandung Conference of 1955, gradually took over the initiative. At the Belgrade Conference in September 1961, President Tito launched the idea of a World Conference on Trade and Development. A few weeks later (7 December 1961), GATT responded with a declaration on the need for rapid and sustained expansion of export earnings of less developed countries, including a pronouncement that "aid can be no substitute for trade" and a call for reduction of restrictions on access to DC markets for LDC products. A fortnight after this (19 December), the UN General Assembly endorsed President Kennedy's designation of the 1960s as the "UN Development Decade" and passed Resolution 1707, which gave approval in principle to the idea of a conference. In the following year, another nonaligned conference (Cairo, June 1962) gave more precise form to the demand for a conference on trade and development. The Western countries now abandoned their opposition. ECOSOC resolved to convene UNCTAD (now known as UNCTAD I), established a preparatory committee, appointed Prebisch secretary-general of UNCTAD, and invited him to prepare a report to outline the issues.[170]

The report which Prebisch submitted to the conference was entitled "Towards a New Trade Policy for Development." H. G. Johnson has said of it that it was "an unusually comprehensive, well-balanced and philosophically coherent analysis and set of recommendations for promoting the development of the less developed countries through changes in the trade policy of the developed countries."[171] Starting out from a historical survey of the nineteenth-century pattern of world trade and its breakdown in the Great Depression of the 1930s, Prebisch argued that the "Old Order" could no longer serve the needs of development, and that merely negative policies of removal of trade barriers had to be supplemented by positive policies to assist the trade of developing countries. A restatement of his familiar thesis about the terms of trade for primary products provided the basis for a program designed to raise and stabilise the prices of primary products by commodity agreements and to make good by compensatory finance losses of export earnings from worsening terms of trade. It was a program which, in Johnson's words, extended "to primary-producing less developed countries the types of protection that developed countries extend to their own primary producers, with the significant difference that the subsidies involved would go to the governments and not the individual producers of those countries."[172]

The main policy innovation of the Prebisch report was a new emphasis on the need for developing countries to export manufactures. The Great Depression had "compelled industrialization to turn inwards like a simple import substitution process—simple but costly. . . . The Second World War gave this form of inward-looking industrialization still further impetus." The policy had helped raise income but much less than "a rational policy of combining import substitution with industrial exports" would have done. The simple and relatively easy phase of import substitution was reaching its limits in most advanced industrialising LDCs. The relative smallness of their national markets added to other adverse factors. Excessive protectionism had "generally insulated national markets from external competition, weakening and even destroying the incentive necessary for improving the quality of output and lowering costs under the private-enterprise system. It had thus tended to stifle the initiative of enterprises as regards both the internal market and exports."[173]

Whereas a few years earlier Prebisch had questioned the import substitution strategy merely because of its failure to yield significant saving of foreign exchange, he now conceded much of the classical case against it, chiefly that it deprives countries of the dynamic benefit of international trade, which Haberler had recently restated in his influential Cairo lectures.[174] But the inference Prebisch drew was not the desirability of general liberalisation of trade, by developing as by developed countries, but a case, on infant industry or "infant economy" grounds, for nonreciprocal concessions by developed countries. The GSP scheme for LDC exports of manufactures which he proposed to the conference followed fairly closely that outlined in the ECE study of 1960.

As Johnson pointed out, the program which Prebisch presented to UNCTAD and which has remained the core of the Third World's demand for a New International Economic Order was based on "a philosophy of international economic policy that might be described as the internationalization of protectionism for less developed countries."[175] To this extent, it constituted a step, though as yet only a small step, towards an outward-looking development strategy.

Outward-Looking Policies

Meanwhile, and increasingly during the 1960s, while a frustrating and often acrimonious North-South dialogue[176] arose from UNCTAD I, with the South pushing for the Prebisch program and the North for multilateral tariff negotiations coupled with grudging acceptance of the principle of LDC preferences, the case for outward-looking industrial development strategy was carried much further than Prebisch had taken it. The most influential contribution to this case was made by an ambitious study of the industrialisation experience of a number of developing countries which was initiated at the OECD Development Centre by I. M. D. Little (whose interest in these problems had been stimulated by a period working in the Planning Commission in New Delhi) and which culminated in the Little-Scitovsky-Scott report *Industry and Trade in Some Developing Countries.*[177] Other contributions were made by a team at the World Bank associated with Bela Balassa;[178] by the London-based Trade Policy Research Centre, which initially tried to promote the idea of an Atlantic Community as an alternative to British entry into the Common Market but later concentrated on propagating the case for freer trade;[179] and by a Tokyo-centred group which in conferences and papers on Pacific trade and development lent its weight to the case while injecting some ideas with a Japanese flavour into the discussion.[180]

In part, the case for more outward-looking policies drew on mounting evidence in industrialising LDCs of the adverse effects of the import substitution strategy to which Prebisch had already pointed in his report. One of the first studies outside Latin America was one by John Power of the Pakistan case.[181] Power noted that the saving rate had failed to rise as had been hoped and suggested that "the character of the industrialization itself, with its emphasis on import substitution—especially the replacement of imported consumption goods—

had something to do with it."[182] Import licensing, initially to conserve foreign exchange, gave greater encouragement to domestic production of consumption goods than of capital goods, and of inessential than of essential consumption goods. In a necessarily small home market, it could not take advantage of economies of scale, and, in the absence of backward linkages or opening of export markets, the momentum of industrial development based on import replacement could not easily be maintained. "There is no natural, spontaneous evolution from the kind of 'hot-house' industrial growth induced by shutting out imports to . . . self-sustaining growth."[183]

The Little-Scitovsky-Scott report, drawing on the experience of seven countries, strongly reinforced and extended this negative case. "The studies on the seven countries indicate that these countries have now reached the stage where policies that are followed to promote import-substitution are proving harmful for the economic development of these countries. Industrialization sheltered by high levels of protection had led to the creation of high-cost enterprises; these enterprises are producing expensive products, many of which are for use by a restricted middle class, and so production is rapidly coming up against the limits of the home market. . . . With high industrial prices, maintained behind high tariffs, industrialization has been carried out at a high cost to agriculture. . . . Ponderous administrative control has held up decisions and has led to excessive stocks and the creation of a multitude of firms operating below capacity. . . . The most serious result of these policies, however, is that the nascent industries have come to depend for their profits on government decisions, and so have formed the habit of devoting their efforts to obtaining privileges by pressure on the government rather than by cutting their costs."[184]

To the negative experience of import substitution in some industrialising countries was added the encouraging experience of an increasing number of small countries, chiefly but not exclusively in East and Southeast Asia, which appeared to be successful in following the earlier example of Japan by pursuing an export-oriented strategy based on export of labour-intensive manufactures. The first "showcase example of industrialization for export," noted in the literature as early as 1959, was that of Puerto Rico, but this could be regarded as a special case because of its preferential access to the US market.[185] To some extent, this applied also to the second success story of export-led growth, that of Hong Kong, to which Myint drew attention in 1969, since Hong Kong enjoyed useful preference in the United Kingdom.[186]

But by 1967 the list of countries "where the growth of manufactures has been at least somewhat export-oriented" had lengthened to include Taiwan, South Korea, Israel, Mexico, and Pakistan.[187] Several of these were achieving very high rates of growth of exports of manufactures in the face of DC protectionism and without the benefit of preferential treatment. A study published in that year claimed that "contemporary experience of LDCs in the realm of trade policy has shifted a considerable body of influential opinion . . . towards what might be called an outward-looking strategy of trying to export manufactures early in the process of industrial development." It listed, as the main benefits of such a strategy, increasing returns in production for a larger market and the value of competition: "Export promotion goes hand in hand with efforts to conquer and defend the home market, but a degree of foreign competition is tolerated at home to toughen the competitive fibre of local industries."[188]

When the Asian Development Bank two years later commissioned the study *Southeast Asia's Economy in the 1970s*, the author of the chapter on the manufacturing sector, Helen Hughes, stated the new doctrine very firmly: "The further pursuit of import-substituting, inward-oriented industrialization strategies will lead to more high costs and balance of payments difficulties. In the Philippines, industrial growth had already slowed down in the 1960s, and in Malaysia and Thailand . . . industrial growth is in danger of slowing down in the 1970s, because the relatively easy import-substitution possibilities have been exhausted. An alternative, outward-looking industrialization strategy, already adopted with remarkable success in Singapore, entails a difficult and painful adjustment of policies."[189]

The same volume contained a (primarily) Japanese contribution which supported this general approach—"there is a need to search for new engines of economic growth in the international economy, and to push the development of export-oriented industrial activity appropriate to the economic circumstances, resource endowment, and demand structure of particular developing countries"[190]—but with nuances that reflected Japanese experience and viewpoints. Among these were an emphasis on "horizontal" trade, i.e., exchange of manufactures for manufactures, and on a "new international division of labour" based on the (Heckscher-Ohlin) comparative advantage of developing countries with their cheap and abundant labour and developed countries with their superiority in capital and technology. But since the guiding principle must be "dynamic" comparative advantage which will not be attained through the free market, there was emphasis also on "agreed specialisation"[191] including planned "structural adjustment"[192] in the advanced countries, such as was being undertaken in Japan, and on "planned transfer of manufacturing activity from developed to less developed producers."[193]

Hla Myint, in his overall report in the same volume, endorsed the general recommendation that "the Southeast Asian countries should move away from import-substitution policies towards a radically different approach to industrialization," but gave no support to "agreed specialisation" and was a good deal more cautious about the kinds of export on which LDCs should concentrate. These should not be just labour-intensive—such exports were "likely to face stiff competition." Prospects were best in lines which could make use of specific skills and aptitudes of labour; most promising for resource-rich countries would be a shift from raw to processed materials for which he coined the term "export substitution."[194]

During the 1970s, as growth in the industrialised countries slowed down, trade pessimism revived. Arthur Lewis, in his 1979 Nobel lecture, claimed that "for the past hundred years the rate of growth of output in the developing countries has depended on the rate of growth of output in the developed world. When the developed grow fast, the developing grow fast, and when the developed slow down, the developing slow down." The link between DC and LDC growth has been DC demand for "LDC primary commodities, a link in terms of physical volume, not much affected by prices." As for LDC exports of manufactures, the DCs are "willing to let in manufactured exports only when they are prosperous." Thus, if DC growth cannot be expected henceforth to exceed on average 4 percent a year, LDCs cannot rely on DC markets to achieve the 6 percent growth rate they need (to narrow the gap in per capita incomes, given their higher rate of population growth). They will need increasingly to trade with one another and/or promote further import substitution.[195]

Lewis's thesis did not carry universal conviction. A decade earlier Kravis had pointed out that even in the nineteenth century high rates of economic development had not been closely correlated with export expansion; trade had served as the "handmaiden," rather than as the engine, of growth. "Growth where it occurred was mainly the consequence of favourable internal factors, and external demand represented an additional stimulus which varied in importance from country to country and period to period."[196] As empirical evidence for the 1970s became available, it cast considerable doubt on Lewis's assumption that LDC growth depended on DC demand for primary products. The commodity composition of LDC exports had shifted markedly from primary products to manufactures—though at very different rates, with most countries of Africa remaining dependent on exports of cash crops—and the annual rate of growth of manufactured exports was as high in the 1970s as in the 1960s despite a fall by half in DC real-growth rates.[197] Contrary to Lewis's expectations and widespread fears, DC protectionism had not prevented those developing countries with open economies from significantly increasing their share of the world market.[198] It appeared that LDC export growth depended "less on growth of the market than on the capacity of LDCs to supply manufactured exports at competitive prices,"[199] and this capacity clearly varied greatly among Third World countries.

Of course, it remained arguable that for the majority of LDCs, especially in Africa, Lewis's pessimistic conclusion held

good, and that success in export-oriented industrial development would become more difficult as the number of countries attempting it increased. In fact, while the case for export-oriented industrial development won more adherents during the 1970s, both in theory and in practice, it remained a minority view in the Third World, politically wholly overshadowed by the UNCTAD ideology with its demand for a new international economic order and in the development literature also by the shift of emphasis from economic growth to social objectives. Even its more enthusiastic exponents, both among academics and practitioners, put it forward with qualifications. Most of them conceded that it was more conclusive for small than for large countries,[200] and that import substitution remains "inevitable and legitimate at the outset in most countries."[201] In its more sophisticated version, therefore, the case is not against import substitution as such, but against the notion that, as Myrdal put it in the early 1950s, while manufacturing for exports will become desirable at a later stage of industrial development of underdeveloped countries, "for a long time they have had their hands full in trying to meet the demands of their domestic market."[202] The new view is that "unfortunately, this two-stage theory of development is impractical. It is just too difficult, and at best an extremely slow process, to get away from the first stage *unless* the growth of grossly inefficient industries has been ruthlessly suppressed from the beginning and the second stage has been explicitly kept in view and made an essential ingredient of the economic policies in the first stage."[203] And even the proponents of this austere prescription would presumably admit that it is never too late for a sinner to repent and for a country that began with import substitution pure and simple to change to a more export-oriented policy as soon and as best it can.