State, Market, and Civil Institutions: History of Thought in Development Economics

Principles of analysis of history of thought in development economics

1. Link development and underdevelopment: part of a single process (from Jared Diamond to Carlo Cipolla and Paul Bairoch: world systems).
2. Schools of thought have both positive and normative components:
   - Positive: explain underdevelopment (growth/stagnation, poverty, inequality, vulnerability, basic needs, sustainability, quality of life: theories, models, and data systems)
   - Normative: development strategy (social project endorsed by specific group, ideological, political): objectives, strategies, policies & programs.
3. Link to periods of history of development: four historical periods, five major reversals in thought.
4. Not a classification of people (multifaceted and changing) but of ideas.
5. All theories feature a certain balance between market, state, and civil institutions. They are classified here according to the element among those three on which greater normative emphasis is placed.

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<th>Civil institutions</th>
<th>State</th>
<th>Market</th>
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(4) European socialists & populists

(5) (Marx, Vol I (1867): positive analysis only)
- Poverty of workers. Class struggle. Role of power.

(3) Relative economic backwardness (REB) and catching-up strategies through state intervention in market economies: from France (1820) to Japan (1880)
- Roles of agriculture, protectionism, technology, colonialism and forced savings, industrialization imperative (Gerschenkron and theory of substitutes). - “Western Experience”:
  - Puzzle: Why not China? (Justin Lin).

(1) Antecedents
- Mercantilists (monopolistic trade, colonial accumulation).
- Physiocrats (agriculture): role of agricultural revolution (1700)
- Types of colonies: extraction and settlement.

(2) Classical political economy and industrial revolution in England (1750-1800)

II. 1890-WWII: Colonialism and classical imperialism: First liberal period and “Soviet Experience”

(9) Populists
Chaynov (1925) and the Narodniki: peasant households and communities with no labor market.

(7) Classics of imperialism
- Uneven development and catching-up through market and FDI. Predict transitions to socialism in MDCs due to growth with poverty of workers. Luxemburg (1910), Lenin (1914), Bukharin (1914)

(8) Catching up with command economies: Soviet model (1929)

(10) Keynesian revolution
- Labor market failures and role of the state in underconsumption crisis: fiscal and monetary policies, redistributive policies for growth and welfare state. Keynes (1936), Samuelson

(6) Neo-classical economics

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III. WWII-1980: Growth and development decades: the “Asian Experience”
Marshall Plan, Cold War, Third World, Keynesian revolution, United Nations and Bretton Woods institutions, decolonization of Africa, East-Asian miracles

(16) Neo-populism
Nyerere: African populism.
Schumaker & Bhuddist economics: small is beautiful.
Lipton: urban bias and smallholders.

(17) Group formation & collective action for social incorporation
- Hirschman “Getting Ahead Collectively”, “Exit, Voice and Loyalty”.
- Poverty due to social exclusion: need social incorporation.

(13) Third World socialism & radical dependency theory
- Explain and escape from stagnation: capitalisations = market integration = underdevelopment. Hence, need delinking, collectivization, forced-pace industrialization, central planning, basic needs.

(14) Development economics: state for growth, development planning
State for catching up: protectionism for import substitution industrialization (ISI) given market failures (entry costs and eco. of scale).

1950s: Accelerate aggregate growth
- Mahalanobis: mixed economy planning.
- Aggregate investment.
- Aid for capital, investment, and growth within planning.

1960s: Growth, balance of payments, employment
- Three-gap models (same plus govt. budget deficit): Bacha & Taylor.
- Role of agriculture: Kuznets agricultural surplus (generate, transfer, invest)
- Dual economy models with surplus labor: Lewis, Pin & Fei: role of savings (inequality) and low nominal wages.
- Lele & Mellor: role of technological change in ag. to lower nominal wages.
- Role of sectoral complementarities: linkages and multipliers: Hirschman. Tipping policies.
- Leibenstein: critical minimum effort to escape Malthusian trap.
- Role of market complementarities: Nurkse, Rosenstein-Rodan: big push, balanced growth, domestic market creation (complementarities, coordination).
- Reformist dependency theory: ECLA, Prebisch, Cardoso: ISI.
- Modernizing elites (individual traits and social values): capture the state, leadership.
- Aid for two gaps: relax savings and current accounts constraints. Aid for agriculture (Green Revolution).

(Critique of development economics: neglect of behavior, of macro fundamentals, of political economy of reform).

- Redistribution-with-growth (tax GDP growth): Chenery, WB 60s.
- Agriculture-led growth, trade pessimism: Mellor (Green Revolution, Ag-Ind linkages), Adelman’s ADLI (non-tradables and SAM multipliers).
- Appropriate technology and informal sector: ILO, labor intensive growth, Tokman (dual informal).
- Integrated rural development: WB, IFAD
Women in development
- Basic needs and human development: welfare state. Streeten, UNDP (HDI), UNICEF. Keynesians under the tropics!
- Aid for poverty reduction: basic needs, integrated RD

(11) Modernization theory
- Eurocentric and universalist, evolutionary (diffusion).
- Stages of growth: Rostow
- Normal patterns: Chenery & Taylor, Kuznets
Diffusion of innovations: Rodgers

(12) Neo-classical economic development (1960s)
- Behavioral microfoundations: government for public goods, externalities, competition, property rights, transactions costs, and equity.
- International convergence (Solow): decreasing returns and technology as an international public good.
- Role of agriculture and technological change: Jorgenson: dual economy with full employment, role of technological change in agriculture. Schult: peasants poor but efficient with perfect markets; role of tech change.
- Hayami & Ruttan: induced technological innovations, role of prices in inducement.
- Pluralist theory of the state, political markets, and government capture: Stigler, Peltzman, Becker (Chicago School).
- Project evaluation.
- Poverty due to marginality (marginality theory): need social integration for participation and trickle-down.

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Debt crisis, stabilization and adjustment, end of Cold War, economic recoveries, China boom, democratization, proliferation of NGOs and GROs

(25) New institutional economics
- Role of civil institutions in context of market and govt failures: households, extended family, firms, ROSCAS, group lending; village banks, service cooperatives, sharecropping contracts, interlinked transactions, mutual insurance networks, water users associations, etc. Role of locally public information and social capital. Role of property rights, role of culture and social norms.
- Second generation of reforms (Stiglitz), linkage local-global institutions.
- Transactions costs approach
Coase, Williamson, North, Bowles.
- Imperfect and asymmetrical information approach
Stiglitz, Akerlof, Eswaran & Kotwal, Bardhan, Basu, Bell, Besley.
- Microeconomics of gender, households, contracts, communities, and agrarian institutions
- Comparative historical institutional economics
Nugent, Ostrom, Wade.

(26) Grassroots development:
- New actors, new social movements, GROs and NGOs, informal sector, cooperative organizations, RD beyond the welfare state, decentralization of governance, community participation. Role of social capital.
- Local responses to globalization (Voices from the Commons, SID).
- CJD approach.
- IFAD, IAF: new approaches to rural development.
- Wade, Ostrom, Balad-Plateau: determinants of cooperation and management of CPR vs. Hardin’s tragedy of the commons.
- Critique: communities can fail (lack of democracy, strong redistributive pressures). Devolution can fail. Decentralization can fail (elite capture)

(27) Beyond development
Deconstructionists: Escobar
De-development: reduce consumption.

(21) Endogenous growth: Spillovers and multiple equilibria. Role of initial conditions. Role of state due to market failures.
- Market externalities/demand linkages & Big Push: (coordination of I, redistribution (e.g., land reform): Krugman; Murphy, Schleifer, & Vishny).
- Institutional change: financial intermediation, lower transactions costs on markets (D. North).
- Barriers to the international diffusion of innovations (Baumol)
- Wrong, internal definition of comparative advantage (no eco of scale): Matsuyama lock-in.
- Endogenous technology and human capital; role of income distribution for savings, incentives, and market size: efficiency-equity complementarity (Aghion, Bénabou).
- Location theory: positive agglomeration externalities, clusters (Krugman).
- Divergence (critique of Solow) and conditional convergence (initial conditions, good policy): Solow, D. Roemer, J. Sachs, R. Hall).
- Counter-revolution in development theory“ (Krugman) or nothing new ‘(Bardhan).
- “Reversal of fortune”: good institutions in settlement colonies, bad in extraction colonies, vs. geography (Aceroglu, Robinson).
- Critique of role of TFP vs capital deepening: Young.

(22) New international trade theory
Strategic interventions for eco of scale (subsidy to domestic firms if international monopoly: airbus. Krugman). Industrial policy beyond WTO (Rodeik)

(23) New political economy
- Endogenous government behavior (policy making), political institutions, constitutional economics. Role of good governance complementing markets (Stiglitz).
- Aid following good policies instead of conditionality lending. Seek greater aid effectiveness.
- Public choice and collective action approach
Determinants of cooperation: Olson, Tullock, Buchanan, Aizenman, Applebaum & Katz.
- Time consistency approach
Credibility, commitment, delegation, reputation, overshooting. Tabellini, Alesina, Persson, Staiger.
- Endogenous regulatory mechanisms
Incentives and endogenous regulators; Barro, Noll.
- Comparative historical political economy
East-Asian developmental state and bureaucracy, public firm incentives: Westphal, Evans (embedded autonomy (and corruption?!)), Gold, Wade.
- Transition strategies: political economy of reforms.
- Decentralization strategies.

(24) Sustainable growth and environmental economics
Sustainability as inter-generational equity. Weak and strong sustainability constraints in projects. Brandtland Commission, Pierce.

(18) Neo-liberal response (1980s)
- Efficiency objective through market forces.
- Critique of government intervention: government failures and inefficiencies; corruption.
- Rent seeking, rent distorting: policy distortions (Tullock, Krueger, Baghwati (DUP))
- Incentive and informational problems of govt intervention: cannot solve market failures (Hayek).
- Effectiveness of government interventions doomed by private sector response: rational expectations (Solow, Lucas).
- Open economy industrialization (OEI): role of trade (WB, Edwards). Role of FDI, WTO.
- Trade liberalization to reduce rent seeking (Bates).

(19) Stabilization policies
- Debt crisis and exhaustion of ISI. Inflation, BofCA deficits, Gvt budget deficits.
- Stabilization: Real devaluation, fiscal austerity, restrictive monetary policy, wage repression: IMF.

(20) Adjustment policies, Washington Consensus
- Liberalization of trade and foreign investment (GATT, NAFTA), competitive exchange rate (floating), financial liberalization (emerging financial markets, banking sector reforms), balanced budget & fiscal discipline, privatization (reduce soft budget constraints, raise revenues), domestic market deregulation (DeSoto), tax reforms (VAT instead of trade taxes): Washington Consensus, J. Williamson.
- Role of macrofundamentals but neglect of micro reforms and institutional reforms (Africa).
- Globalization and backlash.
- Aid for stabilization and adjustment, structural reform loans, conditionality lending (WB, IMF), privatization of aid (NGO, FDI).
- “New economics of aid” (Dollar, Collier): failure of conditionality. Good governance and fundamentals as pre-condition.
- Safety nets: social funds.