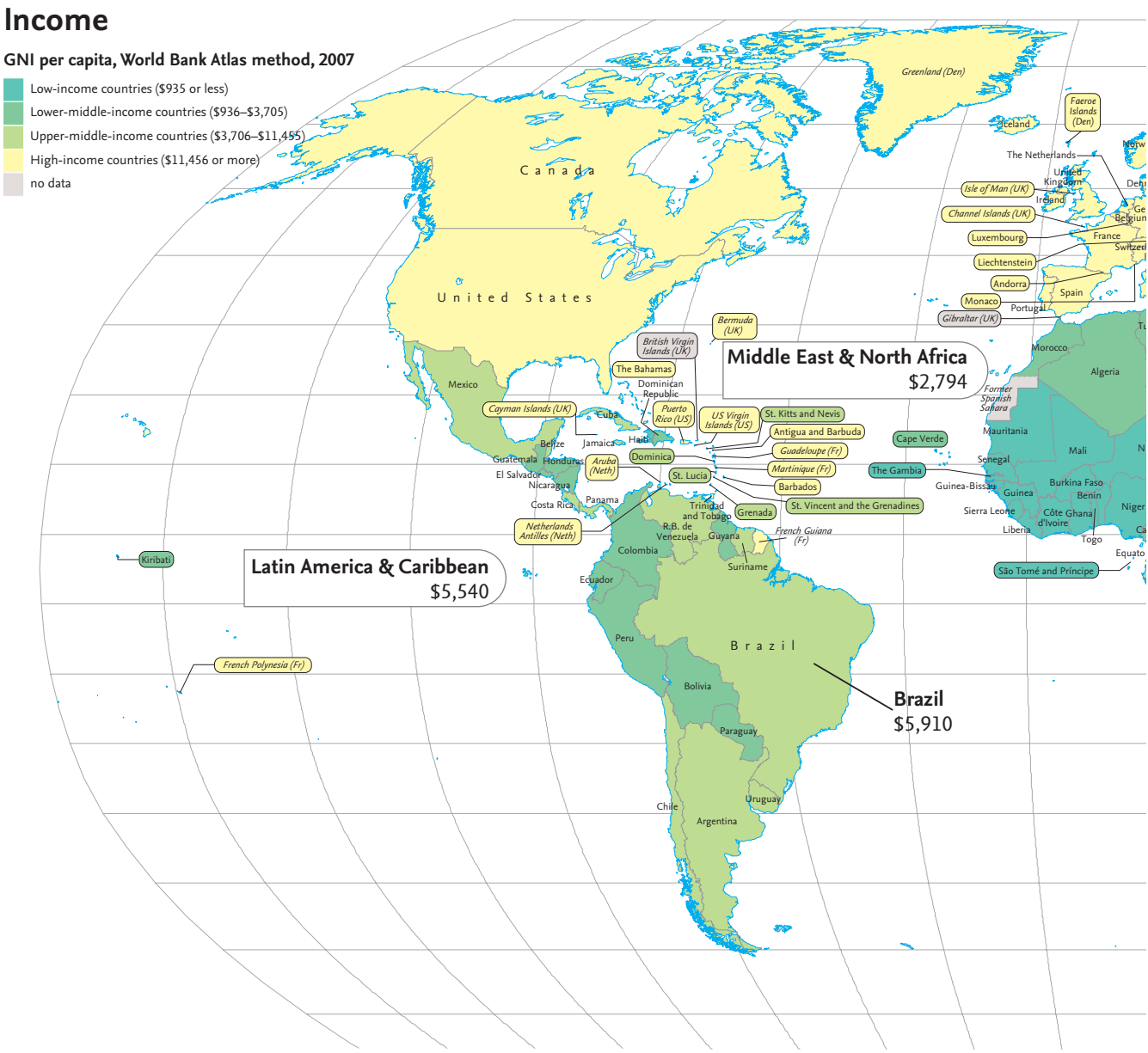
Economic Development

11th Edition

MICHAEL P. TODARO | STEPHEN C. SMITH



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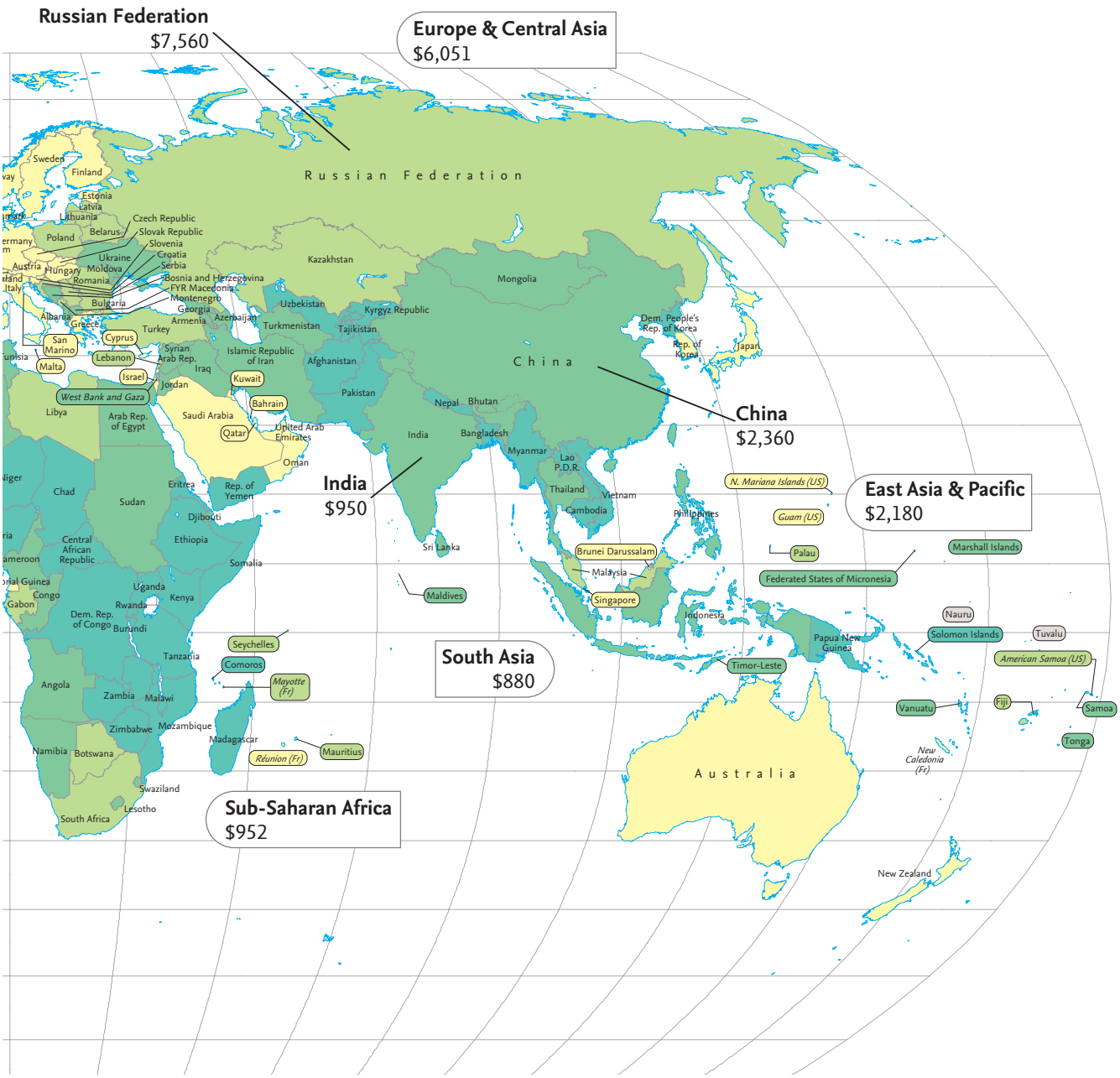
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Economic Development

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Preface

Economic Development, Eleventh Edition, presents the latest thinking in economic development with the clear and comprehensive approach that has been so well received in both the developed and developing worlds.

The pace and scope of economic development continues its rapid, uneven, and sometimes unexpected evolution. This text explains the unprecedented progress that has been made in many parts of the developing world—but fully confronts the enormous problems and challenges that remain to be addressed in the years ahead. The text shows the wide diversity across the developing world, and the differing positions in the global economy held by developing countries. The principles of development economics are key to understanding how we got to where we are, and why many development problems are so difficult to solve; and to the design of successful economic development policy and programs as we look ahead.

The field of economic development is versatile and has much to contribute regarding these differing scenarios. Thus the text also underlines common features exhibited by a majority of developing nations using the insights of the study of economic development. The few countries that have essentially completed the transformation to become developed economies such as South Korea are also examined as potential models for other developing countries to follow.

Both theory and empirical analysis in development economics have made major strides, and the Eleventh Edition brings these ideas and findings to students. Legitimate controversies are actively debated in development economics, and so the text presents contending theories and interpretations of evidence, with three goals. The first goal is to ensure that students understand real conditions and institutions across the developing world. The second, is to help students develop analytic skills while broadening their perspectives of the wide scope of the field. The third, is to provide students with the resources to draw independent conclusions as they confront development problems, their sometimes ambiguous evidence, and real-life development policy choices—ultimately to play an informed role in the struggle for economic development and poverty alleviation.

New to This Edition

- *Global crisis.* A major new section of the text addresses potential longer-term impacts of the recent global financial crisis on economic development, examining conditions that caused the crisis, its aftermath, and possible broader implications and potential differences for developing nations and regions.

- *Violent conflict.* The Eleventh Edition provides an entirely new major section on the causes and consequences of violent conflict, postconflict recovery and development, and prevention of conflict through an improved understanding of its major causes. In the last several years, substantial advances have been made in theory, empirical studies, and policy analysis regarding civil war and civil conflict, one of the leading obstacles to human development and economic growth. The section examines what has been learned about consequences for people and for economic development, causes and prevention of violent conflict, and strategies for postconflict recovery, reconstruction, and sustained development.
- *Findings boxes.* A new textbook feature reports empirical findings in boxes that are wide-ranging in both methods and topics. They address both specific policy concerns—such as improving child health, education, and microfinance design—and a broader understanding of the sources of disparities in the world's economies that can inform the strategy of economic development. And with these findings, they illustrate methods ranging from the use of instruments; randomized control trials; painstaking design, implementation, and robust analysis of survey data; growth diagnostics; and systematically applied qualitative research. The Findings boxes in this edition are listed on pages xvii–xviii. As economic development research findings are published and become influential, they will be reported on the textbook Web site between editions.
- *New comparative case studies.* Two new full-length end-of-chapter comparative case studies are introduced to address current topics and findings and to broaden geographic coverage. An in-depth comparison of Ghana and Côte d'Ivoire appears at the end of Chapter 5, examining themes of the origins of comparative development and of the analysis of poverty causes and remedies. (The updated Grameen case is moved to Chapter 15.) An in-depth comparative study of Haiti and the Dominican Republic is introduced at the end of Chapter 10, demonstrating the influence of environment on development and vice versa, but revealing how environmental degradation stems from deeper causes. All the other case studies have been updated to reflect current conditions and status.
- *New measures.* Measurement is an ever-present issue in the field of economic development. The United Nations Development Program released its Multidimensional Poverty Index in August 2010 and its New Human Development Index in November 2010. The text examines the index formulas, explains how they differ from earlier indexes, reports on findings, and reviews issues surrounding the active debate on these measures.
- *Applications of contemporary models to new topics.* Insights from multiple-equilibria models (explained in detail in Chapter 4) are used to help explain the staying power of violent ethnic conflict and the persistence of harmful cultural practices such as female genital mutilation. The way these insights have helped inspire strategies for ending these practices are explained.
- *Expanded glossary, with definitions in margins where terms are first used.* Each key term is defined in the text at the spot where it is first used. Each of these definitions are also collected alphabetically in the Glossary near the end of the book.

- *Updated statistics.* Change continues to be very rapid in the developing world. Throughout the text, data and statistics have been updated to reflect the most recent available information.
- *Additional updates.* Other updates include an expanded section on microfinance, including new designs, potential benefits, successes to date, and some limitations; Amartya Sen's latest thinking on capability; new evidence on the extent and limits of convergence; expanded coverage of China and the stubborn chronic poverty among hundreds of millions of people despite otherwise impressive global progress; a streamlined Malthus trap model presentation; development implications of new and proposed environmental agreements for developing countries; and growing challenges of adaptation to climate change with examples of efforts that are already underway; as well as topics such as trends in central banking in developing economies. The end-of-chapter case studies have been updated.
- *Convenient numbered subsections.* The introduction of numbered subsections facilitates a tailored course design and extended class focus on selected topics. The text features a 15-chapter structure, convenient for use in a comprehensive course. But the chapters are now subdivided, usually into six to ten numbered subsections in each chapter. This makes it more straightforward to assign topical areas for a class session. It also makes it convenient to use the text for courses with different emphases.

Audience and Suggested Ways to Use the Text

- *Flexibility.* This book is designed for use in courses in economics and other social sciences that focus on the economies of Africa, Asia, and Latin America, as well as developing Europe and the Middle East. It is written for students who have had some basic training in economics and for those with little formal economics background. Essential concepts of economics that are relevant to understanding development problems are highlighted in boldface and explained at appropriate points throughout the text, with glossary terms defined in the margins as well as collected together at the end of the book in a detailed Glossary. Thus the book should be of special value in undergraduate development courses that attract students from a variety of disciplines. Yet the material is sufficiently broad in scope and rigorous in coverage to satisfy any undergraduate and some graduate economics requirements in the field of development. This text has been widely used both in courses taking relatively qualitative and more quantitative approaches to the study of economic development and emphasizing a variety of themes, including human development.
- *Courses with a qualitative focus.* For qualitatively oriented courses, with an institutional focus and using fewer economic models, one or more chapters or subsections may be omitted, while placing primary emphasis on Chapters 1, 2, 5, 6, 8, and 9, plus parts of Chapters 7 and 10, and other selected sections, according to topics covered. The text is structured so that the limited number of graphical models found in those chapters may be omitted without losing the thread, while the intuition behind the models is explained in detail.

- *Courses with a more analytic focus.* These courses would focus more on the growth and development theories in Chapter 3 (including appendixes such as 3.3 on endogenous growth) and Chapter 4, and highlight and develop some of the core models of the text, including poverty and inequality measurement and analysis in Chapter 5, microeconomics of fertility and relationships between population growth and economic growth in Chapter 6, migration models in Chapter 7, human capital theory including the child labor model and empirics in Chapter 8, sharecropping models in Chapter 9, environmental economics models in Chapter 10, tools such as net present benefit analysis and multisector models along with political economy analysis in Chapter 11, and trade models in Chapter 12. It could also expand on material briefly touched on in some of the Findings boxes and subsections into treatments of methods topics such as use of instrumental variables, randomization, and growth empirics including origins of comparative development and analysis of convergence (which is examined in Chapter 2). Endnotes and sources suggest possible directions to take. The text emphasizes in-depth institutional background reading accompanying the models that help students to appreciate their importance.
- *Courses emphasizing human development and poverty alleviation.* The Eleventh Edition can be used for a course with a human development focus. This would typically include the sections on Amartya Sen's capability approach and Millennium Development Goals in Chapter 1, the new section on conflict in Chapter 14, the discussion of microfinance institutions in Chapter 15, and a close and in-depth examination of Chapters 2 and 5. Sections on population in Chapter 6; diseases of poverty and problems of illiteracy, low schooling, and child labor in Chapter 8; problems facing people in traditional agriculture in Chapter 9; relationships between poverty and environmental degradation in Chapter 10; and roles of NGOs in Chapter 11 would be likely highlights of this course.
- *Courses emphasizing macro and international topics.* International and macro aspects of economic development could emphasize section 2.7 on long-run growth and sources of comparative development; Chapter 3 on theories of growth (including the three detailed appendixes to that chapter); Chapter 4 on growth and multiple-equilibrium models; and Chapters 12 through 15 on international trade, international finance, debt and financial crises, direct foreign investment, aid, central banking, and domestic finance. The book also covers other aspects of the international context for development, including the new section on financial crisis, implications of the rapid pace of globalization and the rise of China, the continuing struggle for more progress in sub-Saharan Africa, and controversies over debt relief and foreign aid.
- *Broad two-semester course using supplemental readings.* Many of the chapters contain enough material for several class sessions, when their topics are covered in an in-depth manner, making the text also suitable for a yearlong course or high-credit option. The endnotes and sources offer many starting points for such extensions.

Guiding Approaches and Organization

The text's guiding approaches are the following:

1. It teaches economic development within the context of a *major set of problems,* such as poverty, inequality, population growth, the impact of very rapid urbanization and expansion of megacities, persistent public health challenges, environmental decay, and regions experiencing rural stagnation, along with the twin challenges of government failure and market failure. Formal models and concepts are used to elucidate real-world development problems rather than being presented in isolation from these problems.
2. It adopts a *problem- and policy-oriented approach* because a central objective of the development economics course is to foster a student's ability to understand contemporary economic problems of developing countries and to reach independent and informed judgments and policy conclusions about their possible resolution.
3. It simultaneously uses the *best available data* from Africa, Asia, Latin America, and developing Europe and the Middle East, as well as *appropriate theoretical tools* to illuminate common developing-country problems. These problems differ in incidence, scope, magnitude, and emphasis when we deal with such diverse countries as India, Pakistan, Bangladesh, China, the Philippines, Kenya, Botswana, Nigeria, Ghana, Côte d'Ivoire, Argentina, Brazil, Chile, Mexico, Haiti, and the Dominican Republic. Still, a majority face some similar development problems: persistent poverty and large income and asset inequalities, population pressures, low levels of education and health, inadequacies of financial markets, and recurrent challenges in international trade and instability, to name a few.
4. It focuses on a wide range of developing countries not only as *independent nation-states* but also in their growing *relationships to one another* as well as in their *interactions with rich nations in a globalizing economy*.
5. Relatedly, the text views development in both domestic and international contexts, stressing the *increasing interdependence of the world economy* in areas such as food, energy, natural resources, technology, information, and financial flows.
6. It recognizes the necessity of treating the problems of development from an *institutional* and *structural* as well as a market perspective, with appropriate modifications of received general economic principles, theories, and policies. It thus attempts to combine relevant theory with realistic institutional analyses. Enormous strides have been made in the study of these aspects of economic development in recent years, which are reflected in this edition.
7. It considers the economic, social, and institutional problems of underdevelopment as closely interrelated and requiring *coordinated approaches* to their solution at the local, national, and international levels.
8. The book is organized into three parts. Part One focuses on the nature and meaning of development and underdevelopment and its various manifestations in developing nations. After examining the historical growth

experience of the developed countries and the long-run experience of the developing countries, we review four classic and contemporary theories of economic development, while introducing basic theories of economic growth. Part Two focuses on major domestic development problems and policies, and Part Three on development problems and policies in international, macro, and financial spheres. Topics of analysis include economic growth, poverty and income distribution, population, migration, urbanization, technology, agricultural and rural development, education, health, the environment, international trade and finance, debt, financial crises, domestic financial markets, direct foreign investment, foreign aid, violent conflict, and the roles of market, state, and nongovernmental organizations in economic development. All three parts of the book raise fundamental questions, including what kind of development is most desirable and how developing nations can best achieve their economic and social objectives.

9. As part of the text's commitment to its comprehensive approach, it covers some topics not found in other texts on economic development, including growth diagnostics, industrialization strategy, innovative policies for poverty reduction, the capability approach to well-being, the central role of women, child labor, the crucial role of health, new thinking on the role of cities, the economic character and comparative advantage of nongovernmental organizations in economic development, emerging issues in environment and development, financial crises, violent conflict, and microfinance.
10. A unique feature of this book is the in-depth case studies and comparative case studies appearing at the end of each chapter. Each chapter's case study reflects and illustrates specific issues analyzed in that chapter. In-chapter boxes provide shorter case examples.

Comments on the text are always welcome; these can be sent directly to Stephen Smith at ssmith@gwu.edu.

Supplementary Materials

The Eleventh Edition comes with a comprehensive Companion Website with content by Abbas Grammy of California State University, Bakersfield. Available at www.pearsonhighered.com/todaro_smith, this site offers an online Student Study Guide for each chapter that includes multiple-choice quizzes and sets of graphing and quantitative exercises. In addition, Internet exercises allow students to explore the countries highlighted in the end-of-chapter case studies in more depth. A Recommended Readings section provides links to and questions about additional development resources.

The Web site also links to material for the instructor, including PowerPoint slides for each chapter, which have been expanded and fully updated for this edition by Professor Meenakshi Rishi of Seattle University.

The text is further supplemented with an Instructor's Manual by Pareena G. Lawrence of the University of Minnesota, Morris. It has been thoroughly revised and updated to reflect changes to the Eleventh Edition. Both the PowerPoint slides and the Instructor's Manual can also be downloaded from the Instructor's Resource Center at www.pearsonhighered.com/irc.

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Michael P. Todaro
Stephen C. Smith

PART ONE

Principles and Concepts

1 Introducing Economic Development: A Global Perspective

We have a collective responsibility to uphold the principles of human dignity, equality and equity at the global level. As leaders we have a duty therefore to all the world's people, especially the most vulnerable and, in particular, the children of the world, to whom the future belongs.

—*United Nations,* Millennium Declaration, *September 8, 2000*

Development can be seen . . . as a process of expanding the real freedoms that people enjoy.

—*Amartya Sen, Nobel laureate in economics*

Globalization offers incredible opportunities. Yet exclusion, grinding poverty, and environmental damage create dangers. The ones that suffer most are those who have the least to start with—indigenous peoples, women in developing countries, the rural poor, Africans, and their children.

—*Robert Zoellick, president, World Bank, 2007*

Under necessaries, therefore, I comprehend, not only those things which nature, but those things which the established rules of decency, have rendered necessary to the lowest rank of people.

—*Adam Smith,* The Wealth of Nations

1.1 How the Other Half Live

As people throughout the world awake each morning to face a new day, they do so under very different circumstances. Some live in comfortable homes with many rooms. They have more than enough to eat, are well clothed and healthy, and have a reasonable degree of financial security. Others, and these constitute a majority of the earth's nearly 7 billion people, are much less fortunate. They may have inadequate food and shelter, especially if they are among the poorest third. Their health is often poor, they may not know how to read or write, they may be unemployed, and their prospects for a better life are uncertain at best. Over 40% of the world's population lives on less than $2 per day, part of a condition of **absolute poverty**. An examination of these global differences in living standards is revealing.

Absolute poverty A situation of being unable to meet the minimum levels of income, food, clothing, healthcare, shelter, and other essentials.

If, for example, we looked first at an average family in North America, we would probably find a "nuclear" family of four with an annual income of over $50,000. They would live in a comfortable suburban house with a small

garden and two cars. The dwelling would have many comfortable features, including a separate bedroom for each of the two children. It would be filled with numerous consumer goods, electronics, and electrical appliances, many of which were manufactured outside North America in countries as far away as South Korea and China. Examples might include computer hard disks made in Malaysia, DVD players manufactured in Thailand, garments assembled in Guatemala, and mountain bikes made in China. There would always be three meals a day and plenty of processed snack foods, and many of the food products would also be imported from overseas: coffee from Brazil, Kenya, or Colombia; canned fish and fruit from Peru and Australia; and bananas and other tropical fruits from Central America. Both children would be healthy and attending school. They could expect to complete their secondary education and probably go to a university, choose from a variety of careers to which they are attracted, and live to an average age of 78 years.

This family, which is typical of families in many rich nations, appears to have a reasonably good life. The parents have the opportunity and the necessary education or training to secure regular employment; to shelter, clothe, feed, and educate their children; and to save some money for later life. Against these "economic" benefits, there are always "noneconomic" costs. The competitive pressures to "succeed" financially are very strong, and during inflationary or recessionary times, the mental strain and physical pressure of trying to provide for a family at levels that the community regards as desirable can take its toll on the health of both parents. Their ability to relax, to enjoy the simple pleasures of a country stroll, to breathe clean air and drink pure water, and to see a crimson sunset is constantly at risk with the onslaught of economic progress and environmental decay. But on the whole, theirs is an economic status and lifestyle toward which many millions of less fortunate people throughout the world seem to be aspiring.

Now let us examine a typical "extended" family in a poor rural area of South Asia. The household is likely to consist of eight or more people, including parents, several children, two grandparents, and some aunts and uncles. They have a combined real per capita annual income, in money and in "kind" (meaning that they consume a share of the food they grow), of $300. Together they live in a poorly constructed one- or two-room house as tenant farmers on a large agricultural estate owned by an absentee landlord who lives in the nearby city. The father, mother, uncle, and older children must work all day on the land. The adults cannot read or write; the younger children attend school irregularly and cannot expect to proceed beyond a basic primary education. All too often, when they do get to school, the teacher is absent. They often eat only one or two meals a day; the food rarely changes, and the meals are rarely sufficient to alleviate the children's persistent hunger pains. The house has no electricity, sanitation, or fresh water supply. Sickness occurs often, but qualified doctors and medical practitioners are far away in the cities, attending to the needs of wealthier families. The work is hard, the sun is hot, and aspirations for a better life are continually being snuffed out. In this part of the world, the only relief from the daily struggle for physical survival lies in the spiritual traditions of the people.

Shifting to another part of the world, suppose we were to visit a large city situated along the coast of South America. We would immediately be struck by the sharp contrasts in living conditions from one section of this sprawling

metropolis to another. There is a modern stretch of tall buildings and wide, tree-lined boulevards along the edge of a gleaming white beach; just a few hundred meters back and up the side of a steep hill, squalid shanties are pressed together in precarious balance.

If we were to examine two representative families—one a wealthy and well-connected family and the other of peasant background or born in the slums we would no doubt also be struck by the wide disparities in their individual living conditions. The wealthy family lives in a multiroom complex on the top floor of a modern building overlooking the sea, while the peasant family is cramped tightly into a small makeshift dwelling in a shantytown, or *favela* (squatters' slum), on the hill behind that seafront building.

For illustrative purposes, let us assume that it is a typical Saturday evening at an hour when the families should be preparing for dinner. In the penthouse apartment of the wealthy family, a servant is setting the table with expensive imported china, high-quality silverware, and fine linen. Russian caviar, French hors d'œuvres, and Italian wine will constitute the first of several courses. The family's eldest son is home from his university in North America, and the other two children are on vacation from their boarding schools in France and Switzerland. The father is a prominent surgeon trained in the United States. His clientele consists of wealthy local and foreign dignitaries and businesspeople. In addition to his practice, he owns a considerable amount of land in the countryside. Annual vacations abroad, imported luxury automobiles, and the finest food and clothing are commonplace amenities for this fortunate family in the penthouse apartment.

And what about the poor family living in the dirt-floored shack on the side of the hill? They too can view the sea, but somehow it seems neither scenic nor relaxing. The stench of open sewers makes such enjoyment rather remote. There is no dinner table being set; in fact, there is usually too little to eat. Most of the four children spend their time out on the streets begging for money, shining shoes, or occasionally even trying to steal purses from unsuspecting people who stroll along the boulevard. The father migrated to the city from the rural hinterland, and the rest of the family recently followed. He has had part-time jobs over the years, but nothing permanent. Government assistance has recently helped this family keep the children in school longer. But lessons learned on the streets, where violent drug gangs hold sway, seem to be making a deeper impression.

One could easily be disturbed by the sharp contrast between these two ways of life. However, had we looked at almost any other major city in Latin America, Asia, and Africa, we would have seen much the same contrast (although the extent of inequality might have been less pronounced).

Now imagine that you are in a remote rural area in the eastern part of Africa, where many small clusters of tiny huts dot a dry and barren land. Each cluster contains a group of extended families, all participating in and sharing the work. There is little money income here because most food, clothing, shelter, and worldly goods are made and consumed by the people themselves—theirs is a **subsistence economy**. There are few passable roads, few schools, and no hospitals, electric wires, or water supplies. In many respects, it is as stark and difficult an existence as that of the people in that Latin American *favela* across the ocean. Yet perhaps it is not as psychologically troubling because

Subsistence economy An economy in which production is mainly for personal consumption and the standard of living yields little more than basic necessities of life—food, shelter, and clothing.

there is no luxurious penthouse by the sea to emphasize the relative deprivation of the very poor. With the exception of population growth and problems of the increasingly fragile environment, life here seems to be almost eternal and unchanging—but not for much longer.

A new road is being built that will pass near this village. No doubt it will bring with it the means for prolonging life through improved medical care. But it will also bring more information about the world outside, along with the gadgets of modern civilization. The possibilities of a "better" life will be promoted, and the opportunities for such a life will become feasible. Aspirations will be raised, but so will frustrations as people understand the depth of some of their deprivations more clearly. In short, the **development** process has been set in motion.

Development The process of improving the quality of all human lives and capabilities by raising people's levels of living, self-esteem, and freedom.

Before long, exportable fruits and vegetables will probably be grown in this region. They may even end up on the dinner table of the rich South American family in the seaside penthouse. Meanwhile, transistor radios made in Southeast Asia and playing music recorded in northern Europe have become prized possessions in this African village. In villages not far away, mobile phone use has been introduced. Throughout the world, remote subsistence villages such as this one are being linked up with modern civilization in an increasing number of ways. The process, well under way, will become even more intensified in the coming years.

Finally imagine you are in booming East Asia; to illustrate, a couple born in obscure zhuangs (rural areas) in populous central Sichuan Province grew up in the 1960s, going to school for six years, and becoming rice farmers like their parents. The rice grew well, but memories of famine were still sharp in their commune, where life was also hard during the Cultural Revolution. Their one daughter, call her Xiaoling, went to school for ten years. Much rice they and their commune grew went to the state at a price that never seemed high enough. After 1980, farmers were given rights to keep and sell more of their rice. Seeing the opportunity, they grew enough to meet government quotas, and sold more of it. Many also raised vegetables to sell in a booming city 100 kilometers up the river and other towns. Living standards improved, and they moved a little above the poverty line—though then their incomes stagnated for many years. But they heard about peasants moving first to cities in the south and recently to closer cities—making more money becoming factory workers. When their daughter was 17, farmers from the village where the mother grew up were evicted from their land because it was close to lakes created by an immense dam project. Some were resettled, but others went to Shenzhen, Guangzhou, or Chongqing. Xiaoling talked with her family, saying she too wanted to move there for a while to earn more money. She found a city that had already grown to several million people, quickly finding a factory job. She lived in a dormitory and conditions were often harsh, but she could send some money home and save toward a better life. She watched the city grow at double digits, becoming one of the developing world's new megacities, adding territories and people to reach over 15 million people. After a few years, she opened a humble business, selling cosmetics and costume jewelry to the thousands of women from the countryside arriving every day. She had five proposals of marriage, with parents of single men near where she grew up offering gifts, even an enormous house. She knows many people still live in deep poverty and finds inequality in the city startling. For now she plans to stay, where she sees opportunities for her growing business and a life she never imagined from her village.

BOX 1.1 The Experience of Poverty: Voices of the Poor

When one is poor, she has no say in public, she feels inferior. She has no food, so there is famine in her house; no clothing, and no progress in her family.

—A poor woman from Uganda

For a poor person, everything is terrible—illness, humiliation, shame. We are cripples; we are afraid of everything; we depend on everyone. No one needs us. We are like garbage that everyone wants to get rid of.

—A blind woman from Tiraspol, Moldova

Life in the area is so precarious that the youth and every able person have to migrate to the towns or join the army at the war front in order to escape the hazards of hunger escalating over here.

—Participant in a discussion group in rural Ethiopia

When food was in abundance, relatives used to share it. These days of hunger, however, not even relatives would help you by giving you some food.

—Young man in Nichimishi, Zambia

We have to line up for hours before it is our turn to draw water.

—Participant in a discussion group from Mbwadzulu Village (Mangochi), Malawi

[Poverty is] . . . low salaries and lack of jobs. And it's also not having medicine, food, and clothes.

—Participant in a discussion group in Brazil

Don't ask me what poverty is because you have met it outside my house. Look at the house and count the number of holes. Look at the utensils and the clothes I am wearing. Look at everything and write what you see. What you see is poverty.

—Poor man in Kenya

Listening to the poor explain what poverty is like in their own words is more vivid than reading descriptions of it. Listen to some of the voices of the poor about the experience of poverty in Box 1.1.[1] From these, together with the voices of the poor recorded in Box 5.1 and Box 8.1, it is clear that what people living in poverty need and want extend beyond increased income to health, education, and—especially for women—empowerment. These correspond to enhanced capabilities and to the achievement of the Millennium Development Goals, both of which are introduced later in this chapter.

This first fleeting glimpse at life in different parts of our planet is sufficient to raise various questions. Why does affluence coexist with dire poverty not only on different continents but also within the same country or even the same city? Can traditional, low-productivity, subsistence societies be transformed into modern, high-productivity, high-income nations? To what extent are the development aspirations of poor nations helped or hindered by the economic activities of rich nations? By what process and under what conditions do rural subsistence farmers in the remote regions of Nigeria, Brazil, or the Philippines evolve into successful commercial farmers? These and many other questions concerning international and national differences in standards of living, in areas including health and nutrition, education, employment, environmental sustainability, population growth, and life expectancies, might be posed on the basis of even this very superficial look at life around the world.

This book is designed to help students obtain a better understanding of the major problems and prospects for economic development by focusing specifically

on the plight of the half or more of the world's population for whom low levels of living are a fact of life. However, as we shall soon discover, the process in **developing countries** cannot be analyzed realistically without also considering the role of economically developed nations in directly or indirectly promoting or retarding that development. Perhaps even more important to students in the developed nations is that as our earth shrinks with the spread of modern transport and communications, the futures of *all* peoples on this small planet are becoming increasingly interdependent. What happens to the health and economic welfare of the poor rural family and many others in the developing regions of Asia, Africa, the Middle East, or Latin America will in one way or another, directly or indirectly, affect the health and economic welfare of families in Europe and North America, and vice versa. The steady loss of tropical forests contributes to global warming; new diseases spread much more rapidly thanks to increased human mobility; economic interdependence steadily grows. It is within this context of a common future for all humankind in the rapidly shrinking world of the twenty-first century that we now commence our study of economic development.

Developing countries Countries of Asia, Africa, the Middle East, Latin America, eastern Europe, and the former Soviet Union, that are presently characterized by low levels of living and other development deficits. Used in the development literature as a synonym for less developed countries.

1.2 Economics and Development Studies

The study of economic development is one of the newest, most exciting, and most challenging branches of the broader disciplines of economics and political economy. Although one could claim that Adam Smith was the first "development economist" and that his *Wealth of Nations,* published in 1776, was the first treatise on economic development, the systematic study of the problems and processes of economic development in Africa, Asia, and Latin America has emerged only over the past five decades or so. Although development economics often draws on relevant principles and concepts from other branches of economics in either a standard or modified form, for the most part it is a field of study that is rapidly evolving its own distinctive analytical and methodological identity.[2]

The Nature of Development Economics

Traditional economics is concerned primarily with the efficient, least-cost allocation of scarce productive resources and with the optimal growth of these resources over time so as to produce an ever-expanding range of goods and services. Traditional neoclassical economics deals with an advanced capitalist world of perfect markets; consumer sovereignty; automatic price adjustments; decisions made on the basis of marginal, private-profit, and utility calculations; and equilibrium outcomes in all product and resource markets. It assumes economic "rationality" and a purely materialistic, individualistic, self-interested orientation toward economic decision making.

Traditional economics An approach to economics that emphasizes utility, profit maximization, market efficiency, and determination of equilibrium.

Political economy goes beyond traditional economics to study, among other things, the social and institutional processes through which certain groups of economic and political elites influence the allocation of scarce productive resources now and in the future, either for their own benefit exclusively or for that of the larger population as well. Political economy is therefore concerned

Political economy The attempt to merge economic analysis with practical politics—to view economic activity in its political context.

with the relationship between politics and economics, with a special emphasis on the role of power in economic decision making.

Development economics The study of how economies are transformed from stagnation to growth and from low-income to high-income status, and overcome problems of absolute poverty.

Development economics has an even greater scope. In addition to being concerned with the efficient allocation of existing scarce (or idle) productive resources and with their sustained growth over time, it must also deal with the *economic, social, political*, and *institutional* mechanisms, both public and private, necessary to bring about *rapid* (at least by historical standards) and *large-scale improvements* in levels of living for the peoples of Africa, Asia, Latin America, and the formerly socialist transition economies. Unlike the **more developed countries (MDCs)**, in the **less developed countries**, most commodity and resource markets are highly imperfect, consumers and producers have limited information, major structural changes are taking place in both the society and the economy, the potential for multiple equilibria rather than a single equilibrium is more common, and disequilibrium situations often prevail (prices do not equate supply and demand). In many cases, economic calculations are dominated by political and social priorities such as unifying the nation, replacing foreign advisers with local decision makers, resolving tribal or ethnic conflicts, or preserving religious and cultural traditions. At the individual level, family, clan, religious, or tribal considerations may take precedence over private, self-interested utility or profit-maximizing calculations.

More developed countries (MDCs) The now economically advanced capitalist countries of western Europe, North America, Australia, New Zealand, and Japan.

Less developed countries A synonym for developing countries.

Thus development economics, to a greater extent than traditional neoclassical economics or even political economy, must be concerned with the economic, cultural, and political requirements for effecting rapid structural and institutional transformations of entire societies in a manner that will most efficiently bring the fruits of economic progress to the broadest segments of their populations. It must focus on the mechanisms that keep families, regions, and even entire nations in poverty traps, in which past poverty causes future poverty, and on the most effective strategies for breaking out of these traps. Consequently, a larger government role and some degree of coordinated economic decision making directed toward transforming the economy are usually viewed as essential components of development economics. Yet this must somehow be achieved despite the fact that both governments and markets typically function less well in the developing world. In recent years, activities of nongovernmental organizations, both national and international, have grown rapidly and are also receiving increasing attention (see Chapter 11).

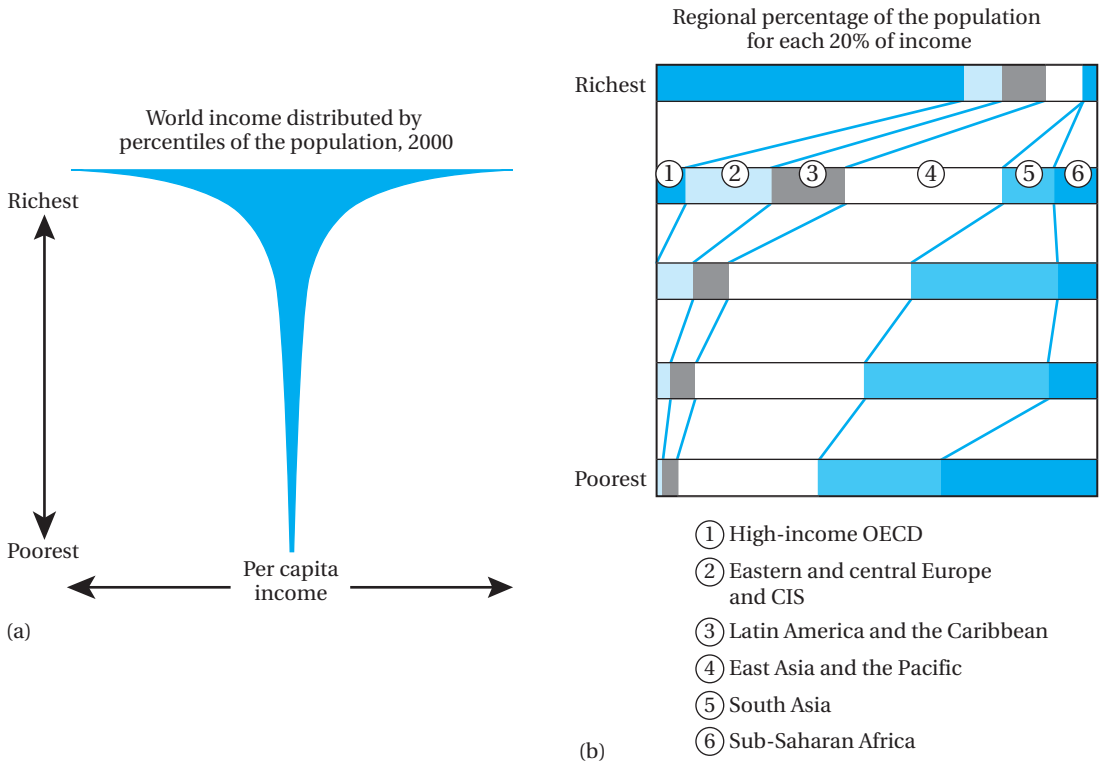
Because of the heterogeneity of the developing world and the complexity of the development process, development economics must be eclectic, attempting to combine relevant concepts and theories from traditional economic analysis with new models and broader multidisciplinary approaches derived from studying the historical and contemporary development experience of Africa, Asia, and Latin America. Development economics is a field on the crest of a breaking wave, with new theories and new data constantly emerging. These theories and statistics sometimes confirm and sometimes challenge traditional ways of viewing the world. The ultimate purpose of development economics, however, remains unchanged: to help us understand developing economies in order to help improve the material lives of the majority of the global population.

Why Study Development Economics? Some Critical Questions

An introductory course in development economics should help students gain a better understanding of a number of critical questions about the economies of developing nations. The following is a sample list of such questions followed by the chapters (in parentheses) in which they are discussed. They illustrate the kinds of issues faced by almost every developing nation and, indeed, every development economist.

1. What is the real meaning of *development*? (Chapter 1)
2. What can be learned from the historical record of economic progress in the now developed world? Are the initial conditions similar or different for contemporary developing countries from what the developed countries faced on the eve of their industrialization? (Chapter 2)
3. What are economic institutions, and how do they shape problems of underdevelopment and prospects for successful development? (Chapter 2)
4. How can the extremes between rich and poor be so very great? Figure 1.1 illustrates this disparity. (Chapters 2, 3, 4, and 5)
5. What are the sources of national and international economic growth? Who benefits from such growth and why? Why do some countries make rapid progress toward development while many others remain poor? (Chapters 2, 3, and 4)
6. Which are the most influential theories of development, and are they compatible? Is underdevelopment an internally (domestically) or externally (internationally) induced phenomenon? (Chapters 2, 3, and 4)
7. What constraints most hold back accelerated growth, depending on local conditions? (Chapter 4)
8. How can improvements in the role and status of women have an especially beneficial impact on development prospects? (Chapters 5, 6, 7, 8, 9, and 10)
9. What are the causes of extreme poverty, and what policies have been most effective for improving the lives of the poorest of the poor? (Chapters 5, 6, 7, 8, 9, 10, and 11)
10. Is rapid population growth threatening the economic progress of developing nations? Do large families make economic sense in an environment of widespread poverty and financial insecurity? (Chapter 6)
11. Why is there so much unemployment and underemployment in the developing world, especially in the cities, and why do people continue to migrate to the cities from rural areas even when their chances of finding a conventional job are very slim? (Chapter 7)
12. Wealthier societies are also healthier ones because they have more resources for improving nutrition and health care. But does better health also help spur successful development? (Chapter 8)
13. What is the impact of poor public health on the prospects for development, and what is needed to address these problems? (Chapter 8)

FIGURE 1.1 World Income Distribution



Part (a) shows world income distribution by percentile. The huge share controlled by the top percentiles gives the graph its "champagne glass shape." Part (b) shows the regional shares of global income. For example, a large majority of people in the top 20% of the global income distribution live in the rich countries. Most of those in the bottom 60% live in sub-Saharan Africa and Asia. OECD is the Organization for Economic Cooperation and Development. CIS is the Commonwealth of Independent States.

Source: From *Human Development Report, 2005,* p. 37. Reprinted with permission from the United Nations Development Programme.

14. Do educational systems in developing countries really promote economic development, or are they simply a mechanism to enable certain select groups or classes of people to maintain positions of wealth, power, and influence? (Chapter 8)
15. As more than half the people in developing countries still reside in rural areas, how can agricultural and rural development best be promoted? Are higher agricultural prices sufficient to stimulate food production, or are rural institutional changes (land redistribution, roads, transport, education, credit, etc.) also needed? (Chapter 9)
16. What do we mean by "environmentally sustainable development"? Are there serious economic costs of pursuing sustainable development as opposed to