ECONOMIC POLICY AND THIRD WORLD POVERTY: POSTWAR THEORY AND PRACTICE

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HISTORICALLY systematic economic writing and research about Third World poverty is very largely a postwar phenomenon. This article discusses first why the economic problems of the poor nations were so long neglected and then traces the evolution of economic research and policy advice in the years since the end of World War II. After a review of some newer policy emphases, I then try to draw some conclusions about the lessons economists may have learned in their approach to Third World poverty.

A. *Prewar Theory and Attitudes*

Amidst the present-day concern with raising living standards in the Third World—nearly all OECD countries have official aid policies and are members of the World Bank group or other multilateral assistance bodies—it is hard to remember that prior to 1945 there was little theoretical or practical concern for the issues of Third World poverty. A few economists in the metropolitan countries discussed the economic and social problems of specific areas like British India or the Dutch East Indies. But there was no attempt to formulate a deliberate economic development strategy for alleviating poverty and raising living standards. There were two major reasons for this situation, one political and the other academic. Firstly, governments in the metropolitan countries themselves excercised only rudimentary control over the economic and social development of the home nations. While it is true that in many of the colonies (e.g., the nineteenth-century Ireland) systematic involvement by the colonial power was more thoroughgoing than in the metropolitan country itself, such involvement was not seen in the context of any overall economic strategy or plan.[1]

If in general governments lacked the means to pursue interventionist economic policies on a systematic basis, it is certainly clear that the dominance of neo-classical orthodoxy in prewar economic thinking discouraged even an academic exploration of the possible shape of such policies. This lack of interest in the issues of growth and development amongst neoclassical thinkers who dominated Anglo-Saxon economics by the end of the nineteenth century contrasted sharply with the intense concern of earlier "classical" writers such as Smith and Marx.

All the classical writers stressed the importance of appropriate institutional preconditions to tackle the stagnating poverty of traditional agrarian societies.[2]

1 See E. Norman [10], particularly his remarks on education and public works in the nineteenth-century Ireland.

2 For Adam Smith only institutional factors would account for the contrasting economic states of Bengal and the American colonies [11, p. 176].

Accordingly, the colonizing process could be seen as potentially providing the necessary legal and cultural framework for raising living standards. Even Marx in his discussion in *Capital* (Vol. 2, Part 7), while aware of the destructive impact of colonial rule (e.g., on Indian handicrafts), also recognized its key role in creating the institutional setting for capitalist development.

By contrast, the neoclassical emphasis on economic equilibrium and marginal adjustments away from or towards such equilibrium, tended to reinforce the popular view of the economy as an essentially self-regulating mechanism. Say's law (stating that excess demands in all markets must sum to zero) seemed to support the general prejudice against the need for interventionist economic policy by governments. Institutional causes of poverty in the colonies were generally ascribed the moral shortcomings of the inhabitants (their heathen beliefs, unproductive tastes and habits, etc.). It was generally accepted that the economic function of the colonial power should be kept to a minimum (e.g., provision of legal tender, maintenance of law and order), while private corporations pursued their commercial interests to the mutual benefit of both peasant, producer, and city shareholder.

B. *Changing Consensus and the Keynesian Revolution*

The gradual erosion of Britain's dominance of the world economy by the end of the nineteenth century and the emergence of the United States, Germany, and later France as major industrial powers began to raise doubts about the viability of conventional economic attitudes. The increasing difficulties of international economic adjustment (especially after 1918) saw substantial practical departures at least in Britain from the accepted noninterventionist role assigned to government. Not, however, until the publication of Keynes's *General Theory* in 1936 was any clear rationale for government management of the economy provided. Keynes in his book undermined the prevailing paradigm of the self-regulating, equilibrating economy by demonstrating the possibility of persistent underemployment. Through his quantification of the relationships between autonomous expenditures (public spending, industrial investment) and national income via the multiplier, he also provided the statistical basis for control of the major economic aggregates (income, consumption, etc.).[3]

The gradual acceptance by politicians, unionists, and industrialists that it was now not only possible but desirable for government to actively manage the national economy was greatly strengthened by the experience of World War II. The prosecution of the war effort led to planned and substantial increases in government's share of GDP in the economics of all the allied powers. Thus the combination of wartime experience and the new theoretical consensus formed the indispensable background to the postwar adoption of Keynesian management policies. This commitment to active government regulation of the economy was formalized in Britain by the Beveridge White Paper of 1944 and in the United States by the 1948 Full Employment Act. The establishment of the International

[3] That Keynes disagreed with his contemporaries, not so much with their policy prescriptions as with their premises is stressed by Moggridge in [8, pp. 61, 62].

Bank for Reconstruction and Development (World Bank) in 1946, though initially concerned with the reconstruction of postwar Europe, signalled the emerging international recognition of the need for active economic policies to raise living standards in poorer areas.

The end of the 1940s therefore saw the institutional and theoretical groundwork for postwar economic policies towards the poorer nations already laid. The beginning of postwar decolonization by the European powers heightened awareness of the desirability and relevance of comprehensive economic plans for the emergent nations of Africa and Asia. On the theoretical front, the work of Harrod and Domar carried Keynes's analysis on the short-period conditions for full employment into the analysis of the necessary conditions for the long-run equilibrium growth of output.

C. *Development Emphasis in the 1950s and 1960s*

In characterizing the general features of postwar development thinking, I am aware that there were always dissenting voices sceptical of the prevailing consensus of economists concerned with analysis and preoccupation for the Third World economics. On the one side have been those like Bauer who have been sceptical of the general mix of interventionism whether through industrial planning or international commodity agreements. Their stress is to rely on the operation of market indicators as the surest guide to more productive use of resources. On the other, there are a collection of critics, some writing as neo-Marxists others as cultural nationalists who have characterized economic policies towards the poorer countries as being the mere rationale for the political and social exploitation of the emergent nations of Africa and Asia. They have criticized what they see as the neglect of the institutional setting of development, and the imposition of alien ideologies on the indigenous cultures.

Notwithstanding the critics I would want to argue that it is possible to discern certain common emphases in writing and policy prescription for the Third World in the immediate postwar period. In retrospect much of the development writing of this period appears to have been characterized by two major trends, the one in overall approach and the other in appropriate policy for economic development. Thus most writers linked economic advancement in the poor regions with measured increases in per capita incomes and plans were formulated in order to generate desired increases. There was only cursory attention to the difficulties of obtaining satisfactory statistical estimates or to the problems of comparability at existing nominal rates of exchange.

The association of successful development with rises in per capita incomes leads directly to the isolation of high rates of population growth as the major statistical cause of low rates of per capita output growth. It is self-evident that the (historically high) rates of population growth experienced in the postwar period by most of the poorer countries (2.5–3.0 per cent p.a.) necessitated higher minimum levels of absolute income and output growth in order to raise the money incomes of the population. An obvious policy inference was therefore to stress the efficacy of measures aimed directly at lowering birth rates as a means of

achieving per capita income targets. More recent experience has however suggested that it is more appropriate to view measures to lower birth rates as complementary to those aimed at raising output rather than as alternatives. Further there has been growing realization that an indicator of development confined solely to per capita income levels needs to be supplemented by broader social comparisons reflecting both equity considerations and the "quality of life."[4]

A distinctive policy consensus of early writing, albeit supported by a variety of analytical models, was the necessity of raising savings ratios to facilitate higher domestic capital formation. The basic theoretical underpinning for this approach was derived from the postwar growth analysis associated with the writing of Harrod and Domar. Historical support for the key role of capital formation was given by the widely discussed model of Rostow's "stage of economic growth" born out of analysis of the industrialization experiences of North America and Europe in the nineteenth century.

In Harrod's post-Keynesian formulation of the growth process, the rate of growth of output is directly determined via some given capital-output ratio (v) by the savings (=investment) ratio.[5] While Harrod was primarily concerned with examining the stability of output expansion in the mature industrialized economies, the assumption of stable capital-output ratios for investment planning has been implicit in many economic plans for the poor countries. Harrod did not discuss the means by which savings ratios might be raised in pursuit of given growth objectives, though he doubted that investment funds were adequately interest-elastic to permit reliance on neoclassical market mechanisms. Lewis's well-known model of the dual economy relies on classical savings assumptions to raise the aggregate savings ratio. The manufacturing (capitalist) sector expands drawing on labor supplies which are unlimited at an exogenously given institutional wage.[6] Since the propensity to save of the capitalists is higher than that of the peasants, the more rapid growth of the modern sector will raise the overall savings ratio from initial subsistence levels to Lewis's desired 12 per cent of the GDP considered adequate for sustained expansion.

A similar stress on the level and direction of industrial capital formation emerges from consideration of the Soviet planning models of the 1920s and 1930s which had a considerable impact on postwar development thinking. These stressed the need to direct investment to the sectors (e.g., heavy industry) with high reinvestment ratios. In the models of Mahalanobis which were influential in the Indian second plan, there is an explicit choice to be made between satisfying consumption needs now and reinvesting the sectoral surplus to enable higher consumption in future periods. The critical parameter determining the rate of

4 A full length exploration of the use of a composite socioeconomic index of development with seventy-three indicators is contained in [13, pp. 44–46].

5 Thus the "warranted" rate of growth of output, g_w, is the product of the savings ratio (s) and the output-capital ratio ($1/v$), where $g_w = s/v$.

6 This is the implicit model underlying Lewis's well-known statement that "the central problem in the theory of economic growth is to understand the process by which the community is converted from being a 5 per cent to a 12 per cent saver" [6, p. 226].

growth of national income is the share of net investment in the capital goods sector (λ_k) assuming uniform output-capital ratios across all sectors.[7]

D. *Sectoral Policies*

The implications of the foregoing stress on raising per capita income levels via aggregate capital formation policies for sectoral strategy should be fairly obvious. All seemed to point to the central place of the industrial sector as the basis for successful development policies, whether because of its higher productivity/man or higher levels of reinvestible surplus. Industrialization provided the obvious setting for the transfer of advanced technology and gave promise of rapid rises in output/man. Some writers stressed the favorable linkage effects with the domestic economy as well as the external economies flowing from the development of indigenous manufacturing. These became consolidated into what has become known as the case for "unbalanced growth" in the discussion of sectoral policies.

While some writers reacted against this extreme stress and the consequent neglect of the agricultural sector, in general the actual direction of policy measures conformed closely with these sectoral prescriptions. Though Lewis himself specifically warned of the need to raise rural sector output/man to maintain the process of development, his use of the elusive "surplus labor" concept encouraged neglect of the incentive costs of labor transfer to the modern sector. It is now widely agreed that even if the marginal productivity of the rural worker is near zero, realization of the "dynamic surplus" in the agricultural sector may require substantial incentives and reorganization of inputs. Releasing workers or extracting food supplies for the urban sector by forcible taxation or collectivization, as undertaken in the Soviet prewar economy, can now be seen to be unproductive and self-defeating.

Not only were early postwar sectoral policies characterized by unnecessary and misplaced neglect of the dynamic potential of the agrarian sector. They were also marked by general pessimism about the possibilities of income expansion through export growth. Concomitant with the stress on industrialization particularly in Latin America was the conviction that long-term income prospects from primary export earnings were unfavorable because of worsening terms of trade. Thus the internal arguments for expansion of manufacturing were reinforced by the general desire (for political and economic reasons) to lessen dependence on primary export earnings to obtain foreign consumer and intermediate goods. Modern sector growth would therefore be not only the vehicle for increased domestic capital formation but also the source of import-saving local production of manufactured goods. Expansion of the manufacturing sector was intended not only to generate higher reinvestible surplus but also to economize on scarce foreign exchange.

E. *Changing Consensus on Development*

For a variety of reasons the postwar consensus of economists on the issues

[7] For an analytical restatement of Mahalanobis's growth models, see [3, pp. 45–51].

of development began to break down as the 1960s ended. First, there was an increasing questioning of the adequacy of using per capita income levels as a useful criterion for economic development. In addition, the concentration on aggregate capital formation as the key to successful economic transformation was seen to neglect the issues of how existing resources might be efficiently used for development. Finally, doubts as to the practicality of the initial stress on industrial sector expansion were raised by the actual experience of several countries.

Some of the impetus for this reappraisal derived from the econometric work on "sources of growth" seeking to estimate the contribution of individual factor input increases to U.S. economic growth in the twentieth century. Early work by Solow and Abramowitz seemed to suggest that unassigned increases in total factor productivity rather than specific increases in capital/man were most significant. Later studies on the U.S. economy suggest that failure to correct for aggregation and measurement errors underestimated the contribution of specific factor inputs to overall output growth. Nonetheless this work for the U.S. economy and subsequent comparative work by Denison for the other industrial economies strongly suggest that the early stress on the role of capital formation tended to neglect the importance of other sources (albeit assignable) of economic growth.[8]

While econometric work in the industrial countries suggested new approaches for Third World development, the practical realities of the first decades of development experience also highlighted deficiencies in the formulation of policies in the immediate postwar period. In this reassessment there are three separate policy issues which necessitated reappraisal of earlier thinking.

1. *Urban employment crisis*

The postwar experience in the poorer countries certainly demonstrated it was possible to expand output in the manufacturing sector at extremely rapid (10 per cent p.a.) rates. At the same time, however, the extent of structural urban

TABLE I
GROWTH RATES OF OUTPUT AND EMPLOYMENT IN THE MANUFACTURING SECTOR—SELECTED COUNTRIES, 1950–60

(% p.a.)

	Output	Employment
Argentina	4.4	–2.0
Brazil	9.8	2.6
Chile	5.4	1.7
Colombia	7.6	2.5
India	6.8	3.3
Kenya (1954–64)	7.6	–1.1
Mexico	6.5	0.4
Peru	6.6	4.4
Venezuela	13.0	2.1
Zambia	12.5	2.0

Source: M. P. Todaro, *Yale Economic Papers,* 1968, No. 8.

[8] The major comparative study of the mid-1960s was [4].

unemployment began to take on serious dimensions. Data from several countries illustrates the divergent rates of manufacturing output and employment growth in the 1950s.

Naturally the seriousness of urban unemployment has varied from country to country and migration patterns have been influenced by a variety of "push-pull" factors. Important for some countries has been the existence of minimum wage legislation (whether union or government enforced) which has preserved large rural/urban income differentials. Much of the installed equipment has reflected the relative factor intensities of the industrialized exporting countries being thus inappropriately capital-intensive. Migration has been accelerated from the rural sector because of the relative stagnation of the subsistence economy and the widespread policy of cheap food provision for the urban workers. What has also become apparent has been not only the seriousness of such urban unemployment (surveyed at 15–20 per cent of the work force in some cities) but also the difficulty of devising adequate policies to check the growth of the unemployed. Todaro in his widely-discussed model of urban migration suggests that the rate of drift to the towns depends not only on the expected rural/urban wage differential but also on the probability of obtaining a job in the modern sector.[9] Further, several writers have suggested that the scope for factor substitution in manufacturing production may be rather limited given the acute shortage of skilled operatives to replace semiautomated procedures. This being so, effective action either to lessen capital-intensity or the urban/rural wage gap may be in practice very hard to implement.

2. *Unequal gains from growth*

Even in countries which have experienced rises in per capita incomes in recent years, it is not clear that these gains have been spread so as effectively to improve the living standards of the poorest in the economy. While the statistical work of Kuznets and others on the historical trends of income equality has suggested that income is more unevenly distributed at lower levels of income, this may reflect only the institutional setting of development in the poorer countries.[10] There appears to be no theoretical necessity for worsening income distribution in order to raise income levels (e.g., by assuming that high savings propensities for capitalist managers than the urban proletariat). It is certainly observable that the last decades have seen the creation of indigenous elites enjoying considerable affluence and absorbing foreign imports. At the same time, most large Third World cities have witnessed rapid mushrooming of shanty dormitories on their outskirts. In certain rural areas where there have been rapid rises in crop yields as a result of application of inputs to new seed varieties the resulting income gains have been unevenly spread between different size farms and regions (e.g., in the Indian states of Punjab or Madras). But whether this is evidence for

[9] For a recent restatement of his model in the African context, see [12, pp. 387–413].

[10] A strong statement of the existence of conflict between growth and redistribution is contained in [1, pp. 302–9].

strictly economic conflict between higher output and more equal distribution or merely of distorting sociopolitical forces it is undeniably true that the benefits of recent output growth in very poor countries have been unevenly spread.

3. *Agricultural sector failures*

Attention to the employment problems of the big cities and the uneven distribution of aggregate income gains has at the same time highlighted the position of the subsistence farmer in the poorer countries. Recent IBRD estimates suggest that 65 per cent of those in the group of the world's poorest (<$200/head) countries live in the rural areas. It is clear that failure to enhance the economic status of the peasant cultivator in these countries has directly contributed to excessive urban drift and reflected the inability of the development process to distribute income gains to the most needy. In many countries in the 1960s food production/head rose little if at all and basic self-sufficiency in grain products worsened by the early 1970s on a global scale. Populous countries like Iraq, Ghana, or Egypt were still spending over 20 per cent of their import outlays on agricultural foodstuffs. Such continuing high levels of importation reflect falling productivity/man and represent wasteful expenditure of undervalued foreign exchange. In many poorer countries the recent rapid rises in basic fertilizer prices have also contributed to lower yields/hectare because of plant food deficiency. Despite record grain harvests (in rice and wheat) in 1975, world grain stocks will remain precarious in face of continuing and massive Russian wheat purchases.[11]

TABLE II

VALUE OF AGRICULTURAL FOODSTUFF IMPORTS IN TOTAL IMPORTS FOR SELECTED COUNTRIES

(%)

	1965	1970
India	30	28
Egypt	32	27
Morocco	39	21
Senegal	40	42
Ghana	13	19
Iraq	24	18

Source: FAO, *State of Food & Agriculture, 1973,* Annex Table 13.

F. *Reappraisal in the 1970s*

These serious practical shortcomings of postwar economic policies in the poor countries have hastened the reappraisal of some of the earlier conventional wisdoms in economic development. In this respect, it is interesting to note the newer stresses in sectoral lending policies evidenced by the international development agencies. It is notable that the World Bank as suggested by MacNamara's

[11] For gloomy view of Third World food provision to 1985, in the face of inadequate fertilizer availability and adverse climatic changes, see [2].

presidential addresses for 1973 and 1975 has shifted attention to policies designed to change the economic situation of the rural and urban poor. Thus the comparative neglect of the rural sector and implicit modern-sector bias of earlier development plans has been recognized and MacNamara is on record as saying that "the heart of the strategy must be the development of policies and project techniques to raise the productivity of small-scale subsistence farmers" (Nairobi, 1973). Indeed generalizing from the recent work in the aid agencies it would be seen that the overall priority for the rural sector must now be to raise output (and so incomes) on albeit reorganized peasant farms, thus eliminating costly food imports. Research suggests that this will require both attractive product prices *and* the provision of an input package of seeds, fertilizers, extension, and credit facilities. Opportunity must also be taken to link the projected expansion of the rural with the manufacturing sector by developing agro-industrial projects. Indigenous processing of local agricultural products not only adds value-added domestically but generates some extra price stability while integrating the rural sector into the modern economy thus reducing dualistic tendencies.

G. *Modern Sector Policies*

Recent critical appraisal of modern sector projects has as suggested highlighted (1) the inability of manufacturing to provide adequate employment opportunities for rapidly growing urban population, (2) the failure of import-substitution policies to generate substantial savings of foreign exchange thus protecting the balance of payments. Recent studies have suggested that value-added in new manufacturing has often been negative when measured at world prices. High levels of effective protection to new industries have also constituted a heavy tax on the export and rural sector.[12] Even at actual (distorted) market prices manufacturing projects may appear unprofitable if lack of complementary inputs (spares, skilled workers) or inadequate markets result in low rates of utilization of fixed plant and equipment.

There is now general recognition of the need to reflect more accurately real opportunity costs, both domestic and international, in planning for industrialization. This may mean correcting overvalued exchange rates, the imposition of capital taxes and eliminating government/union restraints on employment expansion in the "informal sector." Considerable research is now being applied to the generation of appropriate, low-cost technologies which will utilize local materials and indigenous skills. Attention has again been shifted to the need to expand *export* opportunities for the developing economies' manufactured goods. Action here might comprise pressing for less restrictive market access through more generous GSP arrangements as well as encouraging large corporations to shift more labor-intensive processes to the LDCs themselves.[13]

H. *Poor and Rich in the World Economy*

Recent events in the international economy have highlighted the complex

[12] These are some of the policy assessments contained in the OECD study of industrialization and trade in Brazil, Taiwan, Mexico, and Pakistan, brought together in [7].

[13] For discussion of the transfer of employment by transnational firms to the LDCs, see [5].

practical interdependence of the rich and poor nations. There has been a decisive shift from vague, humanitarian concern for international poverty to a growing realization that the economic wellbeing of the rich OECD economies cannot be secured in neglect of the needs of the Third World.[14] Faced first with the commodity price boom of 1972–73 which drove up domestic prices in many OECD countries and the recessionary effects of the massive payments deficits of 1973/74 resulting from the OPEC oil price increases, the rich industrial nations are now well aware that reexpansion of the world economy must also include measures to assist the most seriously affected poor nations (MSAs) as well. Failure by the OECD countries to protect these MSAs from the effects of the current recession in output and trade will sharply curtail export opportunities in the Third World as these countries are forced to protect their payments positions by savage import cuts. Current U.S. proposals for concessionary compensatory financing, through the IMF, of shortfalls in poor countries export earnings are clearly designed not only to head off more radical Third World economic demands but to secure and maintain their economic viability in the international trading community.

I. *Some Concluding Lessons*

Contained within the evolution of development writing and policy since 1945 are important lessons for the next generation of planners and economists in the Third World. First, there has been a proper recognition of the need for a diversity of policy prescription to match the diversity of the poor economies themselves. With this has come an increasing distrust of aggregate economic indicators as adequate guides to past success or future direction of economic policies. Thirdly, in place of policies centering on aggregate capital formation has come recognition of the potential output gains from improved direction of existing savings and utilization of existing technologies and inputs. Not only aggregate-level but also sectoral policies have been subjected to critical review. The growth of urban unemployment had highlighted both shortcomings in industrialization policies as well as the need to revitalize the agricultural sector. Recent lending policies of the aid agencies suggest that sectoral problems are now receiving closer attention. But present reassessment of the usefulness of post-Keynesian planning models should not be allowed to undercut the need for consistent and coherent development strategies in the poorer countries. Greater sensitivity to real opportunity costs and more attention to the institutional and social context of development should make tomorrow's policy advisers more productive if less self-confident.

[14] For a critical view of the role and usefulness of international aid motivated by non-economic aims, see [9, pp. 149–53].

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