



Economic Development

12th Edition

Michael P. Todaro ♦ Stephen C. Smith



Economic Development

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Michael P. Todaro

New York University

Stephen C. Smith

The George Washington University

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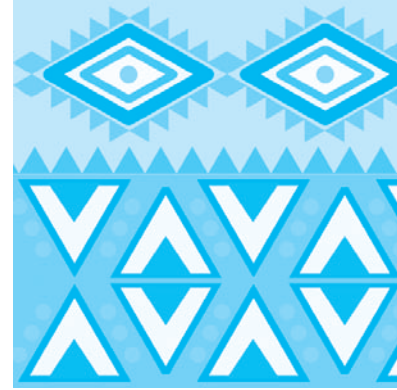
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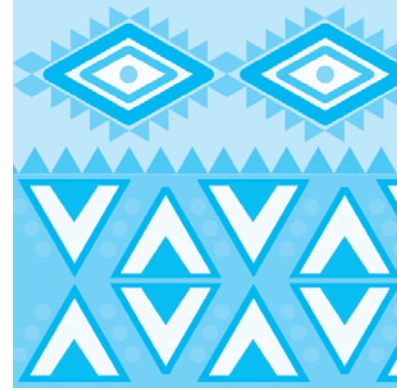
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Preface



Economic Development, Twelfth 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 that are held by developing countries. The principles of development economics are key to understanding how we got to where we are, how great progress has been made in recent years, and why many development problems remain so difficult to solve. The principles of development economics are also key 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 that are 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 Twelfth 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 ending extreme poverty.

New to This Edition

- *Global crisis*. This edition includes a major update and expansion of the new section on the impacts and potential longer-term implications of the recent global financial crisis on economic development, examining

conditions that caused the crisis, its aftermath, and possible broader implications and large differences across developing nations and regions.

- *Prologue in Chapter 1.* Chapter 1 is launched with a new introductory section that describes for students how much has changed over the past two decades in a majority of countries in the developing world and in greater autonomy and nascent leadership of some developing countries in international economic and political relationships. The chapter compares conditions today to those prevailing in 1992—a pivotal period in a number of ways, which is also close to the time when many students were born.
- *Violent conflict.* The Eleventh Edition provided 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; the Twelfth Edition more fully develops and extends this section, incorporating recent developments.
- *Findings Boxes.* The Eleventh Edition also introduced a new textbook feature of Findings boxes, reporting on empirical research results in the field that are wide-ranging in both methods and topics. New Findings boxes address such topics as long-lasting impacts of colonial institutions (Peru); how coordination and monitoring by villagers leads to better health outcomes (Uganda); how social norms facilitated or constrained changing patterns of fertility (Bangladesh); and comparative impacts of conditional versus unconditional cash transfers to the poor (Malawi). Other boxes examine global findings such as unmet contraceptives demand across countries. The number of Findings boxes has been approximately doubled for the Twelfth Edition. The Findings boxes also illustrate empirical methods for students—in an intuitive introductory manner—such as the use of instruments; randomized control trials; regression discontinuity; and fixed effects; as well as the 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.
- *Policy Boxes.* Other boxes address policy issues. New policy boxes examine such topics as the efforts of Niger—one of the world’s poorest countries—to adapt to the climate change already impacting the country and to build resilience against unknown future climate change; and what we learned from the 2011–2012 famine in the Horn of Africa. Other new policy boxes address global findings, such as the extent of contraception use and the extent of still-unmet demand for contraceptives in developing countries; and the UN’s new unexpectedly increased population projections through this century. Policy boxes in this edition are listed on pages xvii–xviii.
- *New, full-length, three-way comparative case study of Costa Rica, Guatemala, and Honduras.* The full-length, end-of-chapter comparative case studies have long been one of the most popular features of the text. For this edition, an entirely new three-way comparative case study of Costa Rica, Guatemala, and Honduras is introduced at the end of Chapter 14, which addresses topics of conflict, foreign investment, remittances, and foreign aid; the study also addresses the themes of very long-term comparative development addressed in some of the existing and updated case

studies, such as those comparing Ghana and Côte d'Ivoire; Pakistan and Bangladesh; and Haiti and the Dominican Republic. Each of the comparative cases also has a special theme, such as human development, poverty, environment, and structural transformation.

- *New topics.* Other new topics briefly introduced in this edition include short sections on the new firm-level international trade research and the developing countries; the emergence of “Sustainable Development Goals” as successors to the MDGs; corporate social responsibility; and food price trends.
- *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. Each has been updated since its initial release, as covered in the Twelfth Edition. Note: From surveys we know many instructors are still using the traditional Human Development Index (HDI), which is reasonable, since it permeates a majority of the literature on the subject. So, we have maintained a very substantial and detailed section on the traditional HDI, which now appears in a new Appendix 2.1 in Chapter 2; it includes a number of country applications and extensions, as in previous editions. You can teach either or both of the indexes, without losing the thread in later chapters.
- *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 at the time of revision, typically 2011 or 2012, and sometimes 2013.
- *Additional updates.* Other updates include a further expansion of the section on microfinance, including new designs, potential benefits, successes to date, and some limitations; further expanded coverage of China; and expanded coverage and analysis of the growing environmental problems facing developing countries.

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.

- The text features a 15-chapter structure, convenient for use in a comprehensive course and corresponding well to a 15-week semester but with enough breadth to easily form the basis for a two-semester sequence. However, the chapters are now subdivided, making it easier to use the text in targeted ways. To give one example, some instructors have paired the sections on conflict (14.5) and on informal and micro finance (15.4) with Chapter 5 on poverty.
- *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 and methods focus.* These courses would focus more on the growth and development theories in Chapter 3 (including Appendices 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. Regarding methods, these courses could also expand on material introduced in some of the Findings boxes and subsections into more detailed treatments of methods topics such as use of instrumental variables, randomization, regression discontinuity, 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 Twelfth 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 policy 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 nongovernmental organizations (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 sections 2.6 and 2.7 on convergence, and 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 (13.6), implications of the rapid pace of globalization and the rise of China (Chapter 12 and such case studies as Brazil in Chapter 1 and China in Chapter 4), the continuing struggle for more progress in sub-Saharan Africa, and controversies over debt relief and foreign aid (Chapter 14).
- *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 focuses 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 that are 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 Twelfth Edition comes with PowerPoint slides for each chapter, which have been expanded and fully updated for this edition.

The text is further supplemented with an *Instructor's Manual* by Chris Marme of Augustana College. It has been thoroughly revised and updated to reflect changes to the Twelfth 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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Our gratitude to the many individuals who have helped shape this new edition cannot adequately be conveyed in a few sentences. However, we must record our immense indebtedness to the hundreds of former students and contemporary colleagues who took the time and trouble during the past several years to write or speak to us about the ways in which this text could be further improved. We are likewise indebted to a great number of friends (far too many to mention individually) in both the developing world and the developed world who have directly and indirectly helped shape our ideas about development economics and how an economic development text should be structured. The authors would like to thank colleagues and students in both developing and developed countries for their probing and challenging questions.

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U.S. Reviewers

Mohammed Akacem, METROPOLITAN STATE UNIVERSITY OF DENVER
William A. Amponsah, GEORGIA SOUTHERN UNIVERSITY
Erol Balkan, HAMILTON COLLEGE
Karna Basu, HUNTER COLLEGE, CITY UNIVERSITY OF NEW YORK
Valerie R. Bencivenga, UNIVERSITY OF TEXAS, AUSTIN

Sylvain H. Boko, WAKE FOREST UNIVERSITY
Michaël Bonnal, UNIVERSITY OF TENNESSEE AT CHATTANOOGA
Milica Z. Bookman, ST. JOSEPH'S UNIVERSITY
Jim Cobbe, FLORIDA STATE UNIVERSITY
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Luc D'Haese, UNIVERSITY OF GHENT
Quentin Duroy, DENISON UNIVERSITY
Can Erbil, BRANDEIS UNIVERSITY
Yilma Gebremariam, SOUTHERN CONNECTICUT STATE UNIVERSITY
Abbas P. Grammy, CALIFORNIA STATE UNIVERSITY, BAKERSFIELD
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Kwabena Gyimah-Brempong, UNIVERSITY OF SOUTH FLORIDA
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Barbara John, UNIVERSITY OF DAYTON
Pareena G. Lawrence, UNIVERSITY OF MINNESOTA, MORRIS
Tung Liu, BALL STATE UNIVERSITY
John McPeak, SYRACUSE UNIVERSITY
Michael A. McPherson, UNIVERSITY OF NORTH TEXAS
Daniel L. Millimet, SOUTHERN METHODIST UNIVERSITY
Camille Soltau Nelson, TEXAS A&M UNIVERSITY
Thomas Osang, SOUTHERN METHODIST UNIVERSITY
Elliott Parker, UNIVERSITY OF NEVADA, RENO
Julia Paxton, OHIO UNIVERSITY
Meenakshi Rishi, SEATTLE UNIVERSITY
James Robinson, UNIVERSITY OF CALIFORNIA, BERKELEY
Monthien Satimanon, MICHIGAN STATE AND THAMMASAT UNIVERSITY
Andreas Savvides, OKLAHOMA STATE UNIVERSITY
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Sharmila Vishwasrao, FLORIDA ATLANTIC UNIVERSITY
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Janice E. Weaver, DRAKE UNIVERSITY
Jonathan B. Wight, UNIVERSITY OF RICHMOND
Lester A. Zeager, EAST CAROLINA UNIVERSITY

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David Barlow, NEWCASTLE UNIVERSITY

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Colin Simmons, UNIVERSITY OF SALFORD
Pritam Singh, OXFORD BROOKES UNIVERSITY
Shinder Thandi, UNIVERSITY OF COVENTRY
Paul Vandenberg, UNIVERSITY OF BRISTOL

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Michael P. Todaro

Stephen C. Smith

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PART ONE

Principles and Concepts





1

Introducing Economic Development: A Global Perspective

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

—Amartya Sen, *Nobel laureate in economics*

Our vision and our responsibility are to end extreme poverty in all its forms in the context of sustainable development and to have in place the building blocks of sustained prosperity for all.

—*Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, 2013*

Under necessities, 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*

We are at an auspicious moment in history when successes of past decades and an increasingly favorable economic outlook combine to give developing countries a chance—for the first time ever—to end extreme poverty within a generation. . . . to create a world for our children which is defined not by stark inequities but by soaring opportunities. A sustainable world where all households have access to clean energy. A world where everyone has enough to eat. A world where no one dies from preventable diseases. A world free of poverty.

—Jim Yong Kim, *World Bank President, 2013*

Prologue: An Extraordinary Moment

Two pictures of the developing world compete in the media for the public's attention. The first is misery in places like rural Africa or unsanitary and overcrowded urban slums in South Asia. The second is extraordinary dynamism in places like coastal China. Both pictures convey important parts of the great development drama. Living conditions are improving significantly in most, though not all, parts of the globe—if sometimes slowly and unevenly. The cumulative effect is that economic development has been giving rise to unprecedented global transformations.

Consider the world of 1992, a time when the divide between the rich developed nations and the low-income developing nations was apparently widening. Rich countries were growing faster than poor countries; and the dominance of high-income industrialized nations in the global order was clear-cut. The United States had just won the Cold War, with the Soviet Union disintegrating in the last days of 1991. The end of the Cold War also saw the European Union in the ascendency, full of confidence with its high-profile Europe '92 Single Market project. The real estate and stock market bubble in Japan was just beginning to deflate, with almost no one predicting

the protracted stagnation that would follow Japan's long period of high economic growth.

Yet in 1992, many developing nations, including Brazil, Russia, India, China, and South Africa (now sometimes grouped by the media as the "BRICS"), found themselves in precarious conditions if not full-scale crisis. Brazil—like most of Latin America—was still struggling to emerge from the 1980s' debt crisis. Russia was descending into depression after the collapse of its Soviet economy. India was trying to rebound from its worst economic crisis since independence. China had launched its period of very rapid growth, but the 1989 massacre in Tiananmen Square was a fresh memory and future prospects for reform and growth in China were uncertain. Meanwhile, the end of apartheid was still being negotiated in South Africa, while the continent as a whole was entering its second consecutive lost decade of slow economic growth, and pessimism prevailed. Despite pressing development needs, there were widespread concerns that with the end of the Cold War, the rich world would lose interest in development assistance. And at the 1992 Earth Summit, while the world was taking its first tentative steps to acknowledge and try to restrain climate change due to global warming, almost no one imagined that 20 years later China and India would be among the top three greenhouse gas emitters.

But since 1992, we have moved from a sharp dualism between a rich Center and a backward Global South periphery to more dynamic and complex relationships. Asia has been growing at an average rate almost triple that of high-income Western countries, and growth has returned to Africa, heralding the promise of an era of global convergence.¹ The scale of transformation is immense.

Health has improved strongly, with dramatic declines in child mortality; and the goal of universal primary education is coming into sight. Poverty has fallen. While about two-fifths of the global population lived in extreme poverty in 1990, the fraction has fallen to about one-fifth today. The number of people living in extreme poverty in China (on less than \$1.25 per day) fell from about 743 million in 1992 to 157 million in 2009. India has seen substantial, if less dramatic, reductions in poverty; social programs in Brazil such as Bolsa Familia have helped substantially reduce the country's once intractable poverty problems. The enormous growth of innovations such as mobile phones and of availability of credit for small enterprises have led to benefits and fueled a new optimism.

At the same time, the future of economic development and poverty reduction is far from assured—many people who have come out of poverty remain vulnerable, the natural environment is deteriorating, and national economic growth remains uncertain. Economic development is a process, not of years, but of many decades. After the 2011 media celebration of the "BRICS" economic growth, there were reminders that the process remains uneven and uncertain. In Brazil economic growth fell from a spike of close to 7.5% in 2010 to under 1% in 2012. Growth in India, topping 10% for the first time in 2010, fell to barely a third that level in 2012. Growth in China fell from over 10% in 2010 to below 8% in 2012 with projections of a permanently slower pace of perhaps 7%. In 2012 growth in South Africa was little more than 3%. Growth per person was slower as populations continued to grow. When financial markets were

unsettled during the summer of 2013, many investors started withdrawing money from these and other developing countries.

Meanwhile, many in the development community were dismayed by a 2013 report showing the number of people living in poverty in Africa had yet to decline, and the average income of those remaining poor had still not risen above its long-term level of just 70 cents per day. And climate change talks, also launched in 1992, proceeded at a snail's pace, even as greenhouse gas emissions reached record levels and the impacts of climate change had become all too visible in low-income countries, threatening to reverse progress in South Asia as well as Africa.

But while optimism that other countries could soon match China's historically high growth rates dimmed, nonetheless the potential for dramatic catch-up remained as bright as ever. The media pessimism that prevailed in the summer of 2013 was no more warranted than the blind optimism of just two years earlier. Realism is needed—both about the daunting challenges and the exciting opportunities. Gains for the developing world in recent years have been genuine and substantial—in some cases transformative—with many developing countries steadily closing the gap with the developed world, particularly in health and education, and very often in income. Prospects remain strong in coming years, particularly for middle-income countries; yet the high volatility of growth is just one hint at the remaining broader development challenges, as we will examine throughout this text.

This book will explain what lies behind the headline numbers and the sweep of development patterns, presenting the necessary analytic tools and the most recent and reliable data—on challenges ranging from poverty to international finance. To begin, even today many of the world's poorest people have benefited little, if at all, from the new global prosperity.

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 more than 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. About two-fifths 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.

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

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

include computer hard disks made in Malaysia, DVD players manufactured in Thailand, garments assembled in Bangladesh, 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 might be 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 find 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 two (and sometimes just one) meals per 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. For families such as theirs, 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 would be 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 would be 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 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.

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.

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.

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, 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 and is growing rapidly. 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, let’s call her Xiaoling, went to school for ten years. Much of the 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, 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 having in her village.

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

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



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 crippled; 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

poor about the experience of poverty in Box 1.1.² 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 (and its emerging successor, the Sustainable Development Goals), 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? What are the implications of the surprisingly long stagnation in rich countries following the financial crisis for further progress on development and poverty reduction? 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 broad-based economic development, paying special attention to 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 poor rural families 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.³

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.

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

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

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