ECONOMIC DEVELOPMENT
Fifth Edition

E. Wayne Nafziger analyzes the economic development of Asia, Africa, Latin America, and East-Central Europe. This book is suitable for those with a background in economics principles. Nafziger explains the reasons for the recent fast growth of India, Poland, Brazil, China, and other Pacific Rim countries and the slow, yet essential, growth for a turnaround of sub-Saharan Africa. The fifth edition of the text, written by a scholar of developing countries, is replete with real-world examples and up-to-date information. Nafziger discusses poverty, income inequality, hunger, unemployment, the environment and carbon-dioxide emissions, and the widening gap between rich (including middle-income) and poor countries. Other new components include the rise and fall of models based on Russia, Japan, China/Taiwan/Korea, and North America; randomized experiments to assess aid; an exploration of whether information technology and mobile phones can provide poor countries with a shortcut to prosperity; and a discussion of how worldwide financial crises, debt, and trade and capital markets affect developing countries.

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Economic Development
FIFTH EDITION

E. Wayne Nafziger
Kansas State University
To Elfrieda in memoriam
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Preface to the Fifth Edition

I wrote this text to increase readers’ understanding of the economics of the developing world of Asia, Africa, Latin America, and East-Central Europe, where about 85 percent of the world’s population lives. The book is suitable for students who have taken a course in principles of economics.

The growth in real income per person in the Third World nations of Latin America, Asia, and Africa, about threefold since 1950, is a mixed record. For some economies, the growth warrants optimism, particularly in Taiwan, South Korea, Singapore, Malaysia, Thailand, Indonesia, China, other fast-growing Pacific Rim countries, Brazil, and, more recently, India. The tragedy, however, is that sub-Saharan Africa, encountering growing misery and degradation from 1965 to 2010, has not shared in these gains. The sub-Sahara is not only vulnerable to the external price shocks and debt crises that destabilized the global economy in the late twentieth century but also is plagued by increasing food deficits, growing rural poverty, urban congestion, and falling real wages; difficulties that represent an inadequate response to adjustment, reform, and liberalization, often imposed by the International Monetary Fund (IMF) or World Bank as a last resort. The problems of Nepal, Afghanistan, Myanmar (Burma), Cambodia, and Haiti are as severe as those of Africa.

This edition expands on previous material analyzing China and other countries that were socialist during most of the post–World War II period. The major upheaval in the field since early 1989 has been the collapse of state socialism in East-Central Europe and the former Soviet Union and economists’ downward revision of estimates of their average economic welfare. Since the late 1980s and early 1990s, postsocialist European countries, like other low- and middle-income countries, have undertaken structural adjustment and market reforms, generally under IMF or World Bank auspices. Yet a substantial proportion of these liberalizing postsocialist economies did not attain their pre-1989 peak in economic welfare by the end of the century. This edition reflects this reality by examples from such countries as Russia, low or lower middle-income Ukraine, and upper middle-income Poland, Hungary, and the Czech Republic and by drawing lessons from their adjustment, stabilization, and liberalization for other middle-income and low-income countries.

Yet I have not allowed the problems of East-Central Europe and the former Soviet Union, important as they are, to overshadow the primary emphasis of the book on Asia, Africa, and Latin America. The major focus is on their real-world problems – from those of newly industrializing countries, such as Taiwan, South
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Korea, Singapore, Malaysia, and Indonesia, to those of the slow-growing sub-Saharan – rather than abstract growth models.

I am gratified by the response of reviewers, instructors, students, and practitioners in the United States, Canada, Europe, Japan, Australia, New Zealand, and the developing world to the emphases in the book’s fourth edition. This revision continues previous themes – such as the origins of modern growth, problems measuring growth, and the origin and resolution of the debt crisis – and integrates social, political, and economic issues and emphasizes poverty, inequality, and unemployment in the discussion of economic policies throughout the book.

As in the fourth edition, this edition takes advantage of the explosion of Internet resources in development economics. For each chapter, I provide an Internet assignment that instructors can use for students to analyze data or write reaction papers by accessing Nafziger, Internet Assignments, at http://www.k-state.edu/economics/nafwayne. The same Web site lists development journals and Internet sites. Moreover, a college’s library may provide access to online journals, expanding the options for assignments accessible at the students’ desktops.

The text incorporates substantial new material to reflect the rapidly changing field of development economics. I have updated tables, figures, and chapters with the most recent data and have revised chapter-end questions to discuss and guides to readings. Finally, the text, which is more user friendly, includes a bibliography and glossary at the end.

The book’s other major features reflect recent literature or readers’ suggestions. Chapter 1, “How the Other Two-Thirds Live,” reminds students of the extent to which only a fraction of the world’s population enjoys the material levels of living of North Americans, Europeans, Japanese, South Koreans, Australians, New Zealanders, and the few affluent in the developing world. Chapter 1 includes sections on globalization, outsourcing, and information technology and Asia’s and India’s recent golden age of development, with its expansion of the middle class, to the comparison of living standards between rich and poor countries. I pose the question: “Which is the major motor of global economic growth: America or Asia?,” with emphasis on highly populated and fast growing China. Chapter 2, on the meaning and measurement of development, examines whether United Nations (UN) Millenium Development Goals for 2015 on “targets for reducing poverty, hunger, disease, illiteracy, environmental degradation, and discrimination against women” are likely to be met.

Chapter 3’s historical perspective includes Jared Diamond’s evolutionary biological approach to development, a sketch of economic development in ancient and medieval times, world leaders in gross domestic product (GDP) per capita during the modern period, why growth was largely confined to the West before the twentieth century, non-Western growth models in the last 100 to 150 years, and whether income levels between rich and poor countries (or between rich and poor individuals) are converging or diverging. Included are sections explaining China’s market socialism and the end of Japan’s economic miracle and the inadequacy of the United States as a development model. The same chapter assesses Ha-Joon Chang’s argument that...
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rich countries used protection and state intervention in their early industrialization but “kicked away the ladder” for poor countries. The chapter is enriched by material from the late Angus Maddison and others about economic growth since the ancient period, the transfer in GDP per capita world leadership from one nation to another during the modern period, the dates when China surrendered the world’s lead in GDP and when it is projected to gain it back, and identification of the golden age of capitalist development.

Chapter 4’s profile analyzes the high proportion of output and the labor force in services in rich countries, the role of institutions in economic development, and the controversy about social capital and growth. In Chapter 5, on development theories, the Murphy–Shleifer–Vishny model helps in understanding the balanced and unbalanced growth discussion and Michael Kremer’s O-ring theory aids in explaining coordination failure.

Chapter 6 expands the discussion of weaknesses of poverty and hunger data, points out the multidimensional nature of poverty, provides data for global and regional poverty rates, looks at how poverty and inequality affect war and political violence, and explains the concepts of $1/day and $2/day poverty. The chapter also critiques the contrasting views of the World Bank, Institute for International Economics, and Sala-i-Martin on how to measure poverty and Sanjay Reddy and Thomas Pogge’s critique of the standard approach to estimating poverty.

Chapter 7 on rural poverty and agricultural transformation, discusses how agriculture affects overall economic growth; examines off-farm sources of rural income; looks at multinational corporations and contract farming in developing countries; provides time-series data on the growth of average food production in rich and poor countries; provides new data on food deficits and food insecurity in developing countries; and scrutinizes the relative importance of fish, meat, and grains in developing countries. The same chapter reworks the section on how poor agricultural policies and institutional failures hamper sub-Saharan African agriculture and compares India and China’s growth in average food output. Other sections include the Hayami–Ruttan induced-innovation model of agricultural development, the benefits and costs of agricultural biotechnology, and the role of multinational corporations and contract farming in developing countries.

Chapters 8 through 13 discuss factors of growth. Chapter 8 on population, includes several new tables and figures and also adds population growth deceleration since 1960 to the emphasis on rapid population growth from 1950 to the present. Chapter 9 updates material on employment and labor-force growth, women in the labor force, and urbanization. Chapter 10 on human capital, expands analyses of how health affects economic development; updates the section on the economic impact of human immunodeficiency virus (HIV)/acquired immunodeficiency syndrome (AIDS), tuberculosis, and malaria on developing countries; and includes a section on mortality and disability, including comparative data on disability-adjusted life years.

Chapter 11 on capital formation, investment choice, information technology, and technical progress includes a substantial section on computers, electronics, and
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Information technology, with a critical analysis of the productivity paradox stating that computers do not show up in measures of total factor productivity. The section’s microeconomic and macroeconomic data give examples of the impact of information technology and growth and compare the lag between computer innovation and growth with those of previous major innovations. Figures and tables show the decomposition of GDP growth, the growth effects of information and communications technology, and the number of mobile phones, Internet users, and personal computers by country or world region.

Chapter 12 on entrepreneurship and organization examines the relationship between long-term property rights and entrepreneurship, the alternative cost of education for entrepreneurs, how liberalization affects returns to entrepreneurship, and the relative income of entrepreneurship and paid employment.

Chapter 13 on natural resources analyzes the literature on resource curse and includes discussion of a revised Nordhaus–Boyer model and its implications for global climate change.

Chapters 14 through 17 integrate macroeconomics and the international economics of development. Chapter 14 on monetary, fiscal, and incomes policy, has sections on how international and domestic capital markets affect the financial system and how adverse selection, moral hazard, and external shocks contributed to financial crises such as those in Mexico (1994), Asia (1997–9), Russia (1998), Argentina (2001–3), and the world’s 2008–9 great recession. Chapter 15 on balance of payments, aid, and foreign investment, has a section on the perverse capital flow from poor to rich countries, including an explanation of massive capital inflows to the United States.

Chapter 16 on external debt and financial crises, has a section on spreads and risk premiums and a detailed analysis of financial and currency crises. These crises relate to sections on World Bank and IMF lending and adjustment programs, the fundamentalists and their critics, reasons for the IMF’s failure to reduce financial crises, the IMF’s sovereign debt restructuring proposal, and new approaches to resolving the debt crises.

Chapter 17 on international trade, has sections on path dependence and comparative advantage and arguments for rich-country tariffs based on income distribution, Third World child labor, and the environment. The discussion of global production networks examines how low-income countries with reduced protection moved up the value-added ladder to expand their low-technology exports. Other topics include trade in services, offshore outsourcing, current intellectual property rights’ rules, currency crises, managed floating exchange rates in countries open to international capital flows, the proliferation of free trade areas, and the euro versus the U.S. dollar as reserve currencies for developing economies.

Chapter 18 analyzes the collapse of state socialism and the transition to liberalization and economic reform in East-Central Europe and the former Soviet Union and the transition to a market economy in China. Their policies contributing to collapse and transition have parallels in the low- and middle-income countries of Africa, Asia, and Latin America. The last section discusses lessons for developing countries from
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the Russian, Polish, and Chinese transitions. The appendix analyzes state planning and the role of the market.

Chapter 19 on stabilization, adjustment, and reform, investigates attaining both internal and external balances, the universality of adjustment in developing and transitional countries, the roles of the World Bank and IMF in balance-of-payments and domestic macroeconomic adjustment, sequencing trade, exchange rate, and capital market reforms.

I am indebted to numerous colleagues and students in both the developed and developing world for helping shape my ideas about development economics, including comments and criticisms of John Adams, Edgar S. Bagley, Maurice Ballabon, Thomas W. Bonsor, Antonio Bos, Martin Bronfenbrenner, Robert L. Curry, Jr., Wayne Davis, Lloyd Dumas, David Edmonds, Patrick J. Gormely, Roy Grohs, Margaret Grosh, Ichirou Inukai, Philip G. King, Paul Koch, Bertram Levin, L. Naiken, Elliott Parker, Harvey Paul, James Ragan, James Rhodes, Alan Richards, Gordon Smith, Howard Stein, Shanti Tangri, Roger Trenary, Rodney Wilson, and Mahmood Yousefi; and Scott Parris, Simina Calin, Peggy Rote, and the editorial staff at Cambridge University Press. Fjorentina Angjellari, Gregory Dressman, Jared Dressman, Akram Esanov, Ramesh Mohan, Boaz Nandwa, Abhinav Alakshendra, Mercy Pulumeni, Narayan Chapagain, and Jessica Boulware assisted in graphing, computer work, and critical analysis. Although I am grateful to all, I am solely responsible for any errors.

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I have made every effort to trace copyright owners, but in a few cases this was impossible. I apologize to any author or publisher on whose rights I may have unwittingly infringed.

The book is dedicated to my late wife, Elfrieda, a Canadian volunteer whom I met in Nigeria in 1965 and with whom I shared forty-two years of concern for Third World development. I also wish to thank my sons, Brian and Kevin, and daughter-in-law, Piadad, for their continuing help.
Abbreviations and Measures

Abbreviations

ASEAN Association of Southeast Asian Nations
DCs Developed (high-income) countries
EU European Union
FAO Food and Agriculture Organization of the United Nations
FDI Foreign direct investment
G7 Group of Seven, meeting of the seven major DCs: the United States, Canada, Japan, the United Kingdom, Germany, France, and Italy (European Union representative also attends)
G8 Group of Eight, meeting of G7 plus Russia
G20 Group of twenty, which comprises Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States, and the European Union. These countries work with the International Monetary Fund (IMF), World Bank, and chairs of their designated committees. G20 countries represent about 90 percent of global GNP and two-thirds of the world’s population. Source: IMF Survey, 10.26.2010.
GATT General Agreements on Tariffs and Trade, the predecessor to the World Trade Organization
GDP Gross domestic product
GNI Gross national income (same as GNP)
GNP Gross national product
HDI Human Development Index, UNDP’s measure of development
HIPCAs Highly indebted poor countries
ILO International Labour Organization
IMF International Monetary Fund
LDCs Less-developed (developing) countries, including LICs and MICs
LICs Low-income countries
LLDCs Least-developed countries
MDGs Millennium Development Goals (United Nations, 2000)
MICs Middle-income countries
MNCs Multinational (transnational) corporations
Abbreviations and Measures

NGOs Nongovernmental (nonprofit) organizations
NICs Newly industrializing countries
NNP Net national product
OECD Organisation for Economic Co-operation and Development, comprising high-income countries (including Republic of Korea) plus Czech Republic, Hungary, Mexico, Poland, Slovak Republic, and Turkey
PQLI Physical quality of life index
PRI Partido Revolucionario Institucional (Institutional Revolutionary Party), Mexico
SARS Severe acute respiratory syndrome
SOEs State owned enterprises
UNICEF United Nations Children’s Emergency Fund
UNCTAD United Nations Conference on Trade and Development
UNDP United Nations Development Program
URL Uniform Resource Locator, the address of documents and other resources on the World Wide Web
WTO World Trade Organization, established in 1995, to administer rules of conduct in international trade

Measures

1 hectare = 2.47 acres
1.61 kilometer = 1 mile
2.59 square kilometers = 1 square mile
1 meter = 1.09 yards = 3.3 feet
1 kilogram = 2.2 pounds
2.54 centimeters = 1 inch
28.3 grams = 1 ounce
0.028 cubic meters = 1 cubic feet

The World Gross National Product per Capita, 2008