Sir Arthur Lewis and Development Economics – Fifty Years On

Opening Remarks by ECCB Governor
Sir K Dwight Venner

Sir Arthur Lewis received his Nobel Prize in Economics for his work on and abiding interest in economic development. His work coincided with and inspired some of the most insightful work on development in the 1950s when, with the wave of decolonisation (referred to by Samuel Huntington as the second wave of democratisation), there was an intellectual and political imperative to address the economic advancement of the newly emerging nations.

Development economics has, like most branches of economics, experienced cycles of boom and slump. However, the objects of development, poor countries and poor people have been constant and their plight has become even more obvious in a world of instant communication and greater interdependence. The nature of the development problem however, has been considerably broadened to encompass the rights, obligations, and responsibilities of states and citizens at the community, national, regional and international levels.

The breadth of the concept is clearly captured in the very incisive book by the Nobel laureate in Economics, Amartya Sen entitled "Development as Freedom." Sen identifies five distinct types of freedom namely:

1. Political freedoms
2. Economic facilities
3. Social opportunities
4. Transparency guaranteed
5. Protective security

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He asserts that these "distinct types of rights and opportunities help to advance the general capability of a person."

This is of tremendous significance to all developing countries but, I would claim, particularly to very small states like ours which have to exist in an increasingly globalised world in which the inequalities among states based on economic and military capacity, lead to a lack of democracy at the international level which is not conducive to our further development.

The most vigorous response to this at the national level is the mobilisation of active populations using the instruments of democracy and fashioning a strategic consensus on our position in the world and the particular strategies we will pursue to achieve our objectives. Knowledge and communication are the major instruments at our disposal and they must be fashioned to achieve the goals that we set ourselves. The development strategies, which we adopt, while being technically sound must be informed by wide ranging discussions at the societal level.

Institution building is therefore a priority for us in ensuring that there are permanent mechanisms for deliberative discussions on societal objectives. How this squares with and does not run against the ethos of a multi-party competitive liberal democracy is a matter which the society must resolve.

The task is a daunting one in small and insular island nations. The challenge is even more compelling however, in a globalised world in which the barriers to the flows of goods, services and capital are being lowered or removed. The ability to keep out of things is difficult if not impossible and small island economies must strategically open up if they are to have any chance of survival.

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The laws of biology apply with equal force to economies as they do to other species, in that a stagnant population which takes in no new bodies, ideas, technology would soon implode and suffer from the worst effects of inbreeding. The risk is even greater for small societies such as ours, which at times seem determined, through our work permit laws, alien landholding licenses and cultures of exclusion, to defy the laws of gravity and exacerbate the trends towards stagnation by overprotective policies.

Arthur Lewis in "the Agony of the Eight", one of his most profound tracts, set the boundaries of our development within a regional context which we have all agreed is a critical staging post for our successful insertion into the international economy. This should be the first logical step in an outward oriented policy.

The new millennium has brought new challenges and reopened the issue of development with particular emphasis on the eradication of poverty. The United Nations, the World Bank, the IMF and the international community have, through the Millennium Development Goals, once again attempted to bring clarity and focus to development issues.

It is for this reason that we are extremely pleased to have with us to deliver the Seventh Sir Arthur Lewis Memorial Lecture, Professor Gerald Meier, who has carefully chronicled the progress of development, development economics and its practitioners over several decades. Professor Meier has had a distinguished career. His has been the voice or, more accurately, the pen which through successive editions of the universally acclaimed "Leading Issues in Development Economics", has kept the academic and policy communities focused on the centrality of economic and social progress for the less developed countries of the planet. We welcome Professor Meier.

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Lecture
By Professor Gerald M Meier

Introduction

Mr Chairman, Honourable Prime Minister, Governor ECCB, Ladies and Gentlemen:

I am delighted and honored to be included in these memorial lectures that celebrate the legacy of Sir Arthur Lewis.

Some fifty years ago Lewis became the **leading pioneer** in development economics. In the 1950's, he was the first to establish the subject on a worldwide basis through his large ideas and policy insights. When Dudley Seers and I organised a series of lectures by **Pioneers in Development** (Meier & Seers 1984) at the World Bank, we selected first of all Arthur Lewis as the most outstanding pioneer.

Ideas for development mattered to Lewis, but mainly for their policy implications. To Lewis, the study of why development occurs was not simply to satisfy intellectual curiosity, but it was to be useful in meeting "**the practical needs** of contemporary policy makers." (Lewis 1955: 5). This was his perspective from his first publication on "An Economic Plan for Jamaica," to his last publication.

The initial question that underlay Lewis' writings remains basic for all of us in the international development community—namely, **"Do development economists know how to put things right?"** Fifty years on—this is still the over-riding question.

Ideas for development have naturally evolved over the past half-century—sometimes in response to advances in general economic theory and sometimes by learning from the experiences of the development record—neither of which Lewis could have yet experienced in the 1950s.

I want to consider that evolution, beginning with Lewis' early establishment of development economics as a subject with his **contributions in the 1950s**, and then recalling **Lewis' subsequent critique** of his own work, then the **later ideas and policies** of development economists. I want to relate this evolution in particular to:

- the role of **capital**,
- the impact of **globalisation**,
- the **new development economics**, and
- the role of **government**.

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Subject Matter

The first book I read in development was Lewis' majestic work on The Theory of Growth (1955). Lewis' subject was "the growth of output per head of population." But he immediately recognised that "output may be growing, and yet the mass of the people may be **becoming poorer.**" In an Appendix, Lewis notes that "the advantage of economic growth is not that wealth increases happiness, but that it increases the range of **human choice…**The case for economic growth is that it gives man greater control over his environment, and thereby increases his **freedom."** (420-21)

Most economists then concentrated for decades on growth in GNP, but in recent years the latest Nobel laureate in development—Amartya Sen—has returned to the emphasis on **Development as Freedom** (1999). And one of the worst 'unfreedoms' is poverty.

When Lewis considers what are the sources of growth, he says "growth of output per head depends on the one hand, on the natural resources available, and on the other hand, on **human behavior."** (1955: 10) His book is primarily interested in human behavior at three different levels: namely, the effort to economise, the increase in knowledge and its application, and the increase in the amount of capital or other resources per head. (1955: 11) This is of concern now, but as we shall see, our modern analysis is somewhat different.

Capital Accumulation in a Dual Economy

Lewis first emphasises the **role of capital accumulation in his 1954 article** on "Development with Unlimited Supplies of Labour." This article, which is probably the most cited article in development economics, presented his celebrated dual sector model. In a simple way, the model traces the interaction between the traditional subsistence sector and the modern capitalist sector, as a less developed economy makes the transition from the initial regime of agrarian colonialism to modern industrial growth. In the traditional sector, labor is self-employed as in small family farms, petty trade, or domestic services. In the capitalist sector, enterprises—whether private or state—use reproducible capital, hire labor for a wage, and sell the product for a profit.

Lewis fashions his dual sector model to explain 'the **central problem** in the theory of economic development', which for him is 'to understand the process whereby a community which was previously saving and investing 5 per cent or less of its national income, converts itself into an economy where voluntary saving is about 15 per cent or more of the national income.'

The fundamental relationship between the two sectors is that when the capitalist sector expands, it draws unlimited labour from the surplus reservoir in the noncapitalist sector at the existing wage rate.[1] Employment in the capitalist sector is constrained only by demand, not labour supply.

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Lewis asserts that at a money wage some 50 per cent above the income of subsistence farmers, the capitalist sector could draw as much labour as it wants without at the same time attracting, "much more than it can handle."[2] The rate of growth in the economy therefore depends on the size of the capitalist sector and the share of profits—and hence savings and investment—in national income. As capital accumulates, productivity rises, the demand for labour increases, and eventually—barring a premature rise in wages that cuts into profits—the model will run its course with the unemployed and underemployed labor reservoir eventually becoming exhausted. Real wages then rise, and growth is bounded by an integrated (neoclassical-type) labour market and a fixed saving rate. The textbook's usual neoclassical model of growth in a more developed country then becomes relevant.

Celebrated as the model is, and optimistic as it seemed, Lewis himself **later in the 1980s listed "the principal errors of omission and commission** that have prevented the developing countries from fully exploiting their economic potential. "Here [he said] is what we have failed to do:"

First, we have failed to get the **balance of industry and agriculture right**. "The agricultural deficit has meant that large sections of the population do not get enough food, or the importation of food puts a strain on the balance of payments. Moreover, food prices rise. And the farmer's marketable surplus provides too small a market for industrialisation, so LDC industry is forced into dependence on exporting manufactures to the developed countries, where they are not welcome."

Second, "we failed to get on top of **population growth** early enough…Population explosion reduces the growth rate of output per person; reduces the savings ratio; eats up capital for providing houses and equipment for extra hands instead of better equipment for fewer persons; and in these ways widens the gap of income per head between the industrial and the developing countries."

Moreover, "population pressure in the countryside forces young people to move off the family farms...In overpopulated countries, the surplus spills over into the towns if the towns display an expanding demand for labour. The faster employment grows in the towns, the bigger the spillover. The movement of the last three decades is unprecedented. Most developing countries do not have the capital to absorb 5 to 6 per cent per annum increase in the urban population, so the result is either an explosion of foreign debt, or a vast multiplication of urban slums."

Lewis then recognises the **duality of the modern sector** itself—now the urban sector—into a formal well-organised sub-sector and the small-scale low productivity **informal sub-sector**. The excessive migration results in earnings in the informal sector not substantially different from rural earnings, and in underemployment and open unemployment. But Lewis contends that "even with the population explosion, unemployment would be smaller if LDCs could attain two objectives—less capital intensive technology and more rural development."

A third error in the 1950's according to Lewis is "It took us quite some time to learn that **foreign exchange** can be a separate bottleneck in economic growth…The principal danger is not to recognise the connection between the balance of payments and domestic expenditure; that the net balance is part of an overall equation, so that domestic imbalance turns up as foreign exchange imbalance; that inflation leads directly to loss of reserves; that in making a development plan the question 'which industries will produce the required foreign exchange' is at least as important as any other; and that in carrying out the plan a precondition of success is to have the right exchange rate, defined very roughly as the rate that makes it possible for exports to grow at 6 per cent a year."

And **fourth**, Lewis concludes, "We failed to do enough to improve the **condition of the poor**." Lewis contends, "We know pretty well but not completely what needs to be done to eliminate absolute poverty. The diet is a mixture of land, jobs, and social services…. What lacks is the will of governments to proceed, rather than a programme. …The trick here is to get more for the poor and also more for capital formation, both at the expense of consumption by the non-poor. This is hard to do in practice, because of the political power of the non-poor."[3]

While Lewis in the 1950s had followed classical economists in emphasising physical capital as the fundamental source of growth, some neoclassical economists later **proceeded on to generalise capital** to include not only physical tangible capital, but also now **human capital**, **knowledge capital**, and **social capital**.

They have done so because econometric analysis of an economy's aggregate production function shows that output can increase in greater proportion than inputs. Output is a function of not only an increase in inputs. There is 'something left over'—an **unexplained residual**. This is interpreted as **total factor productivity**—more simply, an increase in the efficiency with which inputs are used. But what causes this increase in output per unit of input?

Initially, the explanation was simply "technological progress". The explanation of what determines technological progress, however, was not to be found in the economist's model. The increase in total factor productivity was simply left as "manna from heaven." This was unsatisfying because total factor productivity is too influential to be left unexplained: it forestalls diminishing returns and provides continual growth. Improving the efficiency with which resources are used will often make a greater difference to growth than investing more heavily.

Economists then turned to human capital for more of an explanation. Improvements in education, training, and health would make managers and labour more productive. Moreover, attention to

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human capital means that the original trade-off between consumption and investment for the intertemporal balancing of welfare must be modified. For social consumption in the form of education, health care, and nutrition will increase productivity and well-being.[4]
More recently, going beyond human capital, the new growth theory now emphasises knowledge capital. Lewis' early chapter on "Knowledge" in his Theory of Growth book is related to this, but the new growth theory articulates the high importance of new ideas or knowledge capital in terms of formal models. Knowledge is a **very special factor of production** that is scarce, but is the one factor that is not subject to diminishing returns. It is like a public good, can be used repeatedly with no additional cost, and has positive spillovers. These models demonstrate that investment in knowledge yields economies of scale and external economies, persists indefinitely, and sustains growth more than physical capital or human capital can do.

Lewis also considered human behaviour, and economists now accept that **behavioural patterns** do differ among countries and that they do matter for development. The link to development, however, need not be through a questionable appeal to "culture", but instead to differences in the quantity and quality of 'social capital.'

Social capital can be divided into **'civil social capital'** and **'government social capital'**. At the micro-level, civil social capital relates to individual values, attitudes, and norms of behaviour. These embody in civil society such attributes as trust, reciprocity, and social cooperation.

At the macro-level, government social capital relates to rules, procedures, and organisation. These embody the rule of law, a strong judiciary, contract enforcement, the absence of corruption, transparency in decision-making, an efficient administrative system—in short, the existence of **state capability and credibility**.

Attributes of social capital are absent or weak in many developing countries. As a result, high information costs, transaction costs, and risk affect managerial capability in both the public sector and private sector.

The question now is how can more productive social capital be accumulated? This is a new form of Lewis' question of "what causes a nation to create institutions which are favorable, rather than those which are inimical to growth? (1955: 11)

Lewis initially recognised the importance of economic institutions in a chapter in his Theory of Growth (1955). There he wanted to consider the "scope which the community's institutions offer" to encourage people to make the effort required for economic growth. Lewis observed that "institutions promote or restrict growth according to the protection they accord to effort, according to the opportunities they provide for specialisation, and according to the freedom of

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maneouvers they permit." (1955: 57) This early **emphasis on incentives** has now become a central part of development economics, albeit in somewhat different form.[5]

The basic question now is how can **high quality institutions** be formed? By an **"institution"** we mean an established way of acting. Civil social capital embodies informal institutions while government social capital relates to formal institutions. The institutions establish the **rules of the game**—the constraints on behaviour and the incentives for patterns of behaviour. The players in the game are **organisations**—firms, political bodies, unions and the Central Bank. They react to the opportunities and incentives offered by institutions.

Institutions, however, can be good or bad for a country's development. Good institutions shape the right incentives for development performance: they promote social capital and thereby facilitate information flows, reduce transaction costs, avoid or resolve conflict, and yield mutually beneficial collective action.

Development economists in the 1970s advised developing countries to **'get prices right'**. Then in the 1980s and 1990s, they said **'get macro policies right.'** Now we say **'get institutions right,'** But the appropriate policies to accomplish this are sadly not yet much better known than when Lewis recognised the historical importance of institutions.

Trade and Development

From his first book to his last, Lewis considered the effects of foreign trade on development in the **context of world economic history**. His main concern over tropical trade from the 1880s to the 1960s was with deterioration in the factoral terms of trade of tropical countries. When he opened his dual sector model to trade, he also noted that to export more, the country might have to suffer a deterioration in its terms of trade or devaluation. Insofar as the price of labour-intensive manufactured exports would be determined by the low productivity in food production and the low real wage of the small farmers, Lewis recommended that productivity in food should be raised through investment, technological change, and government assistance. This could improve the terms of trade.

Lewis is, however, **ambivalent** about the merits of **import substitution industrialisation** as advocated by many in the 1950s and 1960s. He saw some merit to import substitution arguments, especially when there was a wage divergence between the traditional and modern sectors. But he also made statements such as "the planner neglects foreign trade at his peril", or the export of manufactures can act as a "spiritual revolution", or "at low levels of economic activity, production for the foreign market is usually the turning point which sets a country on the road to economic growth. Innovation comes therefore usually first of all in foreign trade." (Lewis 1955: 275-76).

Nonetheless, he warns that "though the expansion of exports has the advantage of being the easiest means of starting the economy on its growth, over-concentration upon exports is just as disadvantageous as over-concentration in any other sector. The disadvantage shows itself in adverse terms of trade." (p. 281). In this quote, however, he has in mind the exporting of tropical primary products—not manufactures.

Later in the 1970s and 1980s, after the East Asian countries had demonstrated the dynamic gains from trade in manufactured exports, Lewis became more attracted to development through trade. Indeed, he returned to the early argument in his 1950 paper on "The Industrialisation of the British West Indies" (Caribbean Economic Review, May 1950)—namely, the case for rapid industrialisation in the West Indies rests chiefly on over-population and the fact that agriculture cannot absorb more people. The **growth of manufacturing industries** is therefore necessary to expand employment, but since the home markets are too limited in demand, "the islands have to export manufactures to outside destinations. Neither their own growing demands, nor the replacement of imports, can provide a **large enough market**" (p38).

In his Nobel lecture (1979), Lewis acknowledged that "the fast pace of world trade (in the second half of the 1960s and 1970s) also played havoc with development theory…In the '40s and '50s we created a whole set of theories which make sense **if world trade is stagnant**—balanced growth, regional integration, the two-gap model, structural inflation—but which have little relevance in a world where trade is growing at eight per cent per annum."

Now, however, when world trade is again growing so slowly, there is a **revival of interest** in both import substitution and preferential treatment for exports. Rather than the old arguments of import substitution versus export promotion, the **forces of globalisation** are now raising the question **whether globalisation creates inequality** both between countries and within a country.

Today the issue is **globalisation and its discontent**. In a previous Lewis lecture, Kari Levitt raised a number of concerns about the impact of globalisation on developing countries, especially in the Caribbean. Kari Levitt asked: "Has globalisation now made it impossible for developing countries to chart their own path to development, according to their endowment of human and natural resources, cultural and institutional heritage, and social imagination? If so, people and societies comprising 80 per cent of the world's population will have to reclaim spaces of policy autonomy to exercise the right to development…. It is time to reclaim the right of nations to policy autonomy, the right to make the best use of one's own resources, and the right to engage in the international economy on one's own terms."(p. 35).

Reinterpreting this view, I would say that the central concern of development economists should now be how globalisation affects inequality among nations and within a nation. But **what**

matters is not globalisation per se. The real forces of globalisation—acting through cross-border flows of information, transportation, technology, and multinationals—cannot be reversed, but they can be managed. What matters is how the forces of globablisation are **managed to share the benefits** of globalisation between rich and poor countries, and between different groups within a country. A retreat to inward looking policies would lead to deeper poverty. Instead, we must make the opportunities of globalisation work for the poor.[6]

If an increase in a country's trade is taken as the criterion of being a **pro-globaliser**, then the essential question is whether this leads to the country's **growth**, and does this growth alleviate **poverty**? Most development economists would now accept a persuasive amount of evidence that growth has been more rapid in the pro-globalisers, and that the more rapid growth has, in turn, diminished poverty and reduced inequality within the pro-globalisers.[7]

A **strong minority position**, however, is being expressed by a former chief economist of the World Bank, Nobel laureate Joseph Stiglitz, who criticises bad management of globalisation and laments its adverse effects on the poor, the environment, and economic stability. The liberalisation of trade and financial and capital markets, he claims, "pushes a particular ideology—market fundamentalism" that is both bad economics and bad politics. More generally, globalisation itself has been governed in ways that are undemocratic and have been disadvantageous to developing countries, especially the poor within these countries." (Stiglitz 2002:1) Echoing earlier critics, Stiglitz contends that the IMF "exhibits a certain paternalism, a new form of the old colonial mentality" (Stiglitz 2002:3). Moreover, "the trade liberalisation agenda has been set by the North. Consequently a disproportionate part of the gains has accrued to the advanced industrial nations, and in some cases the less developed countries have actually been worse off." (Stiglitz 2002:6)

What the evidence for the pro-globalisers and the critique, such as Stiglitz, both imply is that the benefits of globalisation for developing countries and the poor within, **depend on the quality of management** of globalisation forces by both the nation and international institutions. For example, **excessive liberalisation of capital markets** without adequate regulation can lead to financial crises, as we have experienced. In a recent paper on "Counter-Globalisation", Norman Girvan supports a Stiglitz-like critique, and claims "Counter-Globalisation challenges the neo-liberal assumption that markets are "free and fair" and lead to optimal outcomes, which is the theoretical underpinning of global and regional trade liberalisation. This implies that the subjects of market information, market transparency, market regulation and market structure reform are relevant areas for international negotiation."(Girvan 1999: 5)

At a minimum, better management of globalisation requires attention to the **proper sequence of liberalising policies**; an entire set of **complementary policies** for capital market liberalisation;

and **negotiations on market safeguards**, anti-dumping policies, subsidies, textiles, and agriculture in the Doha Development Agenda.

While better management has to take advantage of the opportunities presented by globalisation, it also has to reduce risks. Echoing words of the World Bank's present chief economist, Nicholas Stern, I would say:

First, globalisation is on the whole a positive force for development and poverty reduction, though there are specific measures that the rich countries should take to make globalisation much more favourable to development.

Second, countries need complementary institutions and policies to realise the great potential from globalisation.

Third, these institutions and policies can themselves be strengthened through involvement in international markets that are properly managed with respect to sequencing and regulation to minimise risks.

Finally, there are specific measures that countries themselves can take to ensure that poor people participate in globalisation and benefit from it. These are education, social protection measures to deal with adjustments, and measures to ensure that all regions of a country are connected to the global economy. [Stern 2000: 2]

New Development Economics

Advances in general economic theory during the last two decades have introduced marked **changes in thinking** about development. In both their positive and normative analyses, the changes are so different from traditional mainstream neoclassical economics that Joseph Stiglitz labels the difference the "New Development Economics". (Stiglitz 1986). The difference centers on the **pervasiveness and character of market failures**. Market failures in the form of external diseconomies and public goods have long been recognised, but now the new development economics focuses on severe problems of **information and learning, incentives, incomplete markets, and missing markets, as well as imperfect markets**. Further, it departs from the assumptions and implications of the standard neoclassical growth model by considering the role of institutions, historical legacies, distribution of wealth, adverse selection, moral hazard, coordination failures, multiple equilibria, and poverty traps.

These considerations follow from **the imperfect information paradigm**. Imperfect information and risks are even more pervasive in less developed countries than in developed economies. What is at stake for differential rates of development is more than differences in endowments of factors and capital accumulation, but instead **basic aspects of organisation of the economy**.

The economics of information gives special significance to a country's **financial system** Development economics of the 1950s neglected the importance of finance. Perhaps this was because of Joan Robinson's dictum "where enterprise leads, finance follows." It was thought that finance could not be a bottleneck because it is demand-following: that is, the financial institutions and services are created in response to the demand for these services by investors and savers.

Added to recent experience of financial crises, the new development economics emphasises the importance of organising the financial sector to **improve the quantity and quality of investment**. Earlier attention to financial markets focused on their role of mobilising savings for industrialisation. Now we recognise that financial markets do much more: they fulfil the important functions of agglomerating capital, selecting projects, monitoring, enforcing contracts, transferring, sharing and pooling risks, and recording transactions. In fulfilling these functions, capital markets **deal not only with intertemporal trade but also with risk and information**. The three are inexorably linked together. (Stiglitz 1994: 23)

The new development economics interprets a country's financial sector as being different from other sectors in being characterised by a combination of **information asymmetries**—namely, providers of funds know less about their ultimate use than do the borrowers, and the giving of credit involves intertemporal exchange of future claims on resources for present ones. **There is an inherent element of uncertainty.** The fact that information in credit markets is imperfect and costly to obtain also gives rise to problems of **adverse selection** because of hidden information and to **moral hazard** because of hidden action. High transaction costs may limit trade or prevent the creation of a market. Moreover, efficient intermediation requires diversification, but many developing countries are too small to make this possible.

To minimise these problems—not to mention financial crises—there is a need for **supervision and monitoring** by both markets and non-market supervisory institutions. Given the unique character of finance and the range of market failures to which financial markets are subject, government actions are commonly needed to create new financial institutions and regulate financial market instruments. Government interventions may be especially needed to improve the efficiency of the banking system and secondary markets. Necessary research is now being done on prudential standards. Also, based on the new development economics, more research is being devoted to the effects of various kinds of institutional arrangements for insuring individuals in developing countries against various types of risk and facilitating their access to credit and investment. (e.g. land reform, rural credit markets, and microcredit)

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In terms of social objectives, government actions may provide consumer protection, ensure bank solvency, improve macroeconomic stability, promote competition, stimulate growth, and improve the allocation of resources. Public actions themselves, however, are also subject to constraints and limitations, so that the essential problem of public regulatory policy is to determine **when government action improves market performance** and when, in contrast, private action can take better advantage of information and incentives within the marketplace. (Stiglitz 1994: 36). Through public and private action together, **better and deeper financial systems** support higher rates of growth. Recent studies by the World Bank show that countries with deeper financial systems have been more successful in taking credit away from loss-making firms and re-allocating to profitable investments.

Moreover, if we are to follow Lewis' interest in the context of world economic history, we also now need more analysis of how financial liberalisation in the sense of **expanding, diversifying, and modernising financial services** links to greater participation in the global economy.[8]

Changes in Development Thinking

Fifty years on, the new development economics represents the major change in development thinking. Many of Lewis' insights have been refined and extended over the past half-century. But the most significant addition is the **microeconomics of development** based on the economics of **information** and the emphasis on **institutions** and **incentives**.

Development economists have **slipped**, however, since the time of Lewis and the 1950s in two respects: (i) the failure to extend the analysis of development in the **context of world history**,[9] as Lewis did; and (ii) the failure to focus on development as a **dynamic process** with attention to the interrelation of its parts, as did Lewis.

With the emphasis on the microeconomics of development and the theory of organisation, analysis has become **partial and reductionist** in the sense of going down to particular sectors and to firms and to households.

The subject, however, also requires us to be **synthetic and integrative** so as to understand the relationships of the parts in a wider way, as did Lewis. The large ideas, grand design, and vision of the 1950s are missing.

A second major change is the attention to **empirical observations**. Data sets and case studies have become much more abundant. Before writing his Theory of Growth book, Lewis had supervised Gisela Eisner in her dissertation on Jamaica's National Income, 1830-1930.[10] He called this the case study that accompanied his Theory of Growth.

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Since then there have been more than 50 years of lessons from development experience and a vast accumulation of data **unknown to Lewis**. And statistical and econometric techniques of analysis have become ever more refined. The original challenge, however, remains: this generation of development economists still needs to formulate a relevant theoretical framework to **bring some logical order to the data**. Most important, a **conjuncture with policymaking** has to be established.

This leads to the third major change—the interpretation of the **respective roles of the state and the market**. In the 1950s and 1960s, planning dominated, based on the belief in extensive market failures. In the 1970s and 1980s, in turn, an orthodox reaction set in against government failures and advocated minimalist government. Since the 1990s, it is apparent that there has been a **reaction too far**, and that government has an important role—**especially in a complementary fashion with the market**.

Lewis' views on the state and market also changed over time. In 1952, in his book on economic planning, he could write "backward countries take more readily to planning because their need is so obviously much greater than in advanced counties. And it is also this that enables them to carry it through in spite of error and incompetence. For, if the people are on their side, nationalistic, conscious of their backwardness, and anxious to progress, they willingly bear great hardships and tolerate many mistakes, and they throw themselves with enthusiasm into the job of regenerating their country. Popular enthusiasm is both the **lubricating oil** of planning, and the **petrol of** economic development—a dynamic force that almost makes all things possible." (Lewis 1952: 128)

In his 1955 Theory of Growth book, Lewis distinguished **at least nine functions of government** that he believed were relevant to economic growth: maintaining public services, influencing attitudes, shaping economic institutions, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment, and influencing the level of investment. (Lewis 1955: 376-77).

By 1983, however, in his Presidential address to the American Economic Association, he said that the appeal to government should not imply that government action in the market always gives a better answer than the uncontrolled market, whether in allocation or in distribution. …It is often the case that the imperfect solution of the market could be better than that of the government. The **government needs to be modernised** just as much as the market. Also the assumption that the government 'represents' the people may not hold."

This leads Lewis to conclude that we **need "a theory of government**." In this connection, we have now changed from viewing government as autonomous and an exogenous factor in any

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development analysis to making government endogenous. That is, we must now not take government action as simply ‘given’, but must analyse **why government does what it does** and then determine how its actions could be more effective in promoting development. The “new political economy” attempts this.[11] Crucial for policy reform is an understanding of the reasons for the successes and the failures of government policy. We must also understand what determines **political entrepreneurship** and what induces **political innovations**.

At this point, Lewis would say that the economics seminar must turn into a politics seminar. That is another story, but the implication of the new thinking is that government action and the market are **not substitutes** but rather should be **complements**. The task now is not to determine when one or the other gives a better outcome, but **how the two in complementary fashion** can improve the situation. Recognising the new market failures, we need to undertake cost-benefit analysis of government policies, and determine how state action can support the formation and deepening of markets. The objective should be to have government do what government does best. And government policy should facilitate or complement private sector coordination—not replacing markets but instead **enhancing their functions**.[12] This task of blending public policies with the market will involve much deeper conceptual issues than those that faced central planners in the 1950s. In many ways it will be more difficult to be a policymaker, policy adviser, or policy administrator.

As Lewis threw away one neoclassical assumption to build his famous dual sector model (see note 1), so too now—in applying the new development economics—we must throw away other neoclassical assumptions of a competitive equilibrium model. And as political economists, we must improve the complementary roles of the state and market.

After this attention to development over the past 50 years, we might conclude with the ultimate question: What development successes can we expect in the next 50 years? As Lewis would answer, it all depends on appropriate policies and high quality institutions.

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Endnotes

[1] Lewis' recollection of how he postulated the fundamental relationship in his model is illuminating. He was concerned with the sources of capital formation but could not find an answer for a developing economy in either neoclassical or Keynesian economics. He was also concerned with what determines the relative prices of steel and coffee. Neoclassical economics made no sense for this. Instead, he recalled: "One day in August 1952, walking down the road in Bangkok, it came to me suddenly that both problems have the same solution. Throw away the neoclassical assumption that the quantity of labor is fixed. An 'unlimited supply of labour' will keep wages down, producing cheap coffee in the first case and high profits in the second case. The result is a dual (national or world) economy, where one part is a reservoir of cheap labor for the other. The unlimited supply of labour derives ultimately from population pressure, so it is a phase in the demographic cycle. Simple and basic as it is, the model remains rich in implications for the supply side of the development process, structural transformation from primary production to industrialisation, allocation of labor, distribution of income, the terms of trade, and trade and growth. Lewis, Nobel Lecture, 1979.

[2] Lewis, Development Planning, London, 1966, pp.77-8, 92.

[3] Lewis, "Alternative Strategies: Final Reflections," processed Conference paper "with Chinese colleagues," 1980's? Not catalogued.

[4] See Sen (1997: 10) and citations there.

[5] The need for incentives is the main theme of the recent best-seller book by William Easterley, Elusive Quest for Growth (New York: Basic Books, 2001).

[6] David Dollar and Paul Collier, Globalisation, Growth, and Poverty, World Bank 2002.

[7] See David Dollar, "Globalisation, Inequality, and Poverty Since 1980," World Bank Development Research Group, November 2001.

[8] In this connection, attention may be directed to a new database of financial sector indicators that measure the size, activity, and efficiency of financial intermediaries and markets across countries and over time: Thorsten Beck, Ash Demirguc-Kunt, and Ross Levine, "A New Data Base on the Structure and Development of the Financial Structure," World Bank Economic Review, vol. 14, no.3, 2000: 597-605.

[9] One notable effort, however, is Kevin H. O'Rourke and Jeffrey G. Williamson. Globalisation and History. Cambridge, MA. MIT Press, 1999.

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[10] Published by Manchester University Press, 1961: Eisner, Jamaica, 1830-1930: A Study in Economic Growth.

[11] G. M. Meier (ed.), Politics and Policy Making in Developing Countries (San Francisco, ICS Press, 1991).

[12] See Masahiko Aoki, et al., The Role of Government in East Asian Development (Oxford: Clarendon Press, 1997).