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*Original title in the book proposal: Rethinking Development Economics along the lines of Albert O. Hirschman and Celso Furtado.*

## **Development Economics today: Insights from Hirschman and Furtado**

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### **Abstract**

The widespread failure of market-oriented policies to produce sustained growth and generalized welfare increases in Latin America has led to a renewed interest in the development theories that flourished in the post-WWII era. They were largely set aside after the 1960s, with the exception of developments in Latin America. While many aspects of those writings are still relevant today the international economy changed substantially. Globalization has been at times interpreted as the end of the core-periphery distinction. While this is debatable, policy prescriptions and objectives of the 1950s and 1960s are not necessarily applicable today.

The paper addresses the general question: what remains vital and relevant today of “high development theory”? In which way can those ideas be updated and brought back to the current debate on development? In order to answer these questions, the paper follows two main lines of investigation. It examines Hirschman’s assessment of balanced and unbalanced growth in light of the theory of transformational growth. Precisely structural imbalances play a crucial role in the theory of transformation. That is associated with the rise of new markets and the long-term growth of demand. The second direction of investigation concerns the views of Celso Furtado, which appear open to the investigation of the evolution of consumption

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patterns and via that channel offer yet another angle on the question of market formation in the process of development.

## **1. Introduction**

In the last two decades the analysis of development has been dominated by the questions of globalization and emerging economies, especially with reference to some large developing economies in Asia and Latin America. Interestingly the discussion of development trends has paid little attention to the body of studies and theories that define the field of study, or sub-discipline as labeled by Hirschman, of “development economics”. In this paper we attempt to bring back the attention to development economics by focusing on the work of two prominent theorists, Albert Hirschman and Celso Furtado. The purpose is not any comprehensive study of their contributions – others have done and we will indeed make use of their work - rather a focused examination that we believe can be fruitful to today’s discussion of development and underdevelopment. The main purpose is highlighting a research approach that consists of singling out some fundamental questions of their work and see how they relate to recent theoretical developments. Admittedly this is a partial approach and it is subject to much further development. We would claim however that it is useful for the fundamental question: to what extent the original insights of early theorists lay the ground for an updated theoretical perspective on development in today’s globalized context? This approach presupposes a view of the current trends of development. It should then be said at the on-start that the crisis and at best the slow recuperation in most of the industrialized economies contrasts with a more mixed picture of the emerging economies with cases of still robust growth.

That of course is a matter of specific economic conditions. It does suggest however that the development of the “periphery” is entering a new phase that was unforeseeable twenty years ago, even less when Hirschman and Furtado were writing.<sup>3</sup> This should not be mistaken for a simple-minded optimism, even less for the end of the development problem, quite the opposite. Indeed, the other premise of this work is that the distinction between development and underdevelopment – on which the very basis of development economics rests – is still valid, we are dealing with an economic and historically specific context. In this respect it should be noted that economic and social inequality remain fundamental characteristics of the emerging economies. At the same time we can notice a disturbing parallel with the industrialized economies where the standstill of wages and an

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<sup>3</sup> In the mid-sixties Furtado wrote little book in which he ventured a sort of stagnation forecast for the Brazilian economy. The book was harshly criticized and the forecast turned out to be simply wrong. Celso Furtado *Subdesenvolvimento e estagnação na América Latina*, Civilização Brasileira, Rio de Janeiro, 1968.

increasingly unequal income distribution are also contributing to an increasing inequality. To be sure these are complex and difficult question, the topic of much debate.

This is the background of what is attempted here, that is, to give a new perspective to the work of two of the most famous development theorists, Albert Hirschman and Celso Furtado. Such a perspective arise from the comparison of Hirshman's views on economic development, and in particular his insistence on the unbalanced nature of growth, with the theory of Transformational Growth (Nell, 1988, 1991, 1998). One of the central features of TG is indeed the role of imbalances in the process of development. They feed right into the process by which tranformation sustains the growth of demand. That implies the evolution of patterns of consumption. This aspect is consistenly absent in the discussion of development economics. The interesting exception is Furtado's argument about "depend development".

## ***2. Development Economics as a field of study***

Development economics was established as a new field of study by a handful of theorists in the 1940s and 1950s. Some of them were European émigrés in Great Britain and the United States.<sup>4</sup> Some of their early work focused on the backward regions of Europe. The classic article by Rosestein-Rodan (1943) was written to address the question of industrialization in Eastern and South Eastern Europe. Besides Rosestein-Rodan, the most well known are probably Gerschenkron, Hirschman, Mandelbaum, and Singer.<sup>5</sup> Very important contributions were those in Latin America. Aside from the work of Raul Prebisch, and the Prebisch-Singer hypothesis, they are less known in the North. The point is that this body of theory was largely set-aside after the 1960s. The exception is, to some extent, Latin America, where that tradition remained alive longer, especially in the works developed at CEPAL.

Despite the differences, these early contributions to development theory share some fundamental similarities. Krugman (2005)<sup>6</sup> argues that there a basic model in what he calls "high development theory" and that is Rosenstein Rodan's Big Push argument. The main point is the establishment of large-scale (modern) production in manufacturing (economies

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<sup>4</sup> The emigration from continental Europe, mostly from Nazi Germany, had a major impact on Economics. The most important was what has been called the "Americanization" of Economics; the other was indeed the contribution to the establishment of development economics.

<sup>5</sup> There are of course other major figures. Meier and Seers (1984) list ten scholars as the founding fathers of the discipline, among them also Tinbergen, Myrdal, Rostow, Prebisch, and Lewis.

<sup>6</sup> The article is in Krugman web site. The original argument is however in *the proceedings of a World Bank conference on Development Economics* (Krugman, 1993).

of scale) by drawing workers from unemployment and/or low paying agricultural activities (dualism). Upstream is the large investment necessary to establish modern industry, downstream the effects of higher wages. A large investment in one industry might be unprofitable in isolation; that calls for a plan of coordinated investment in many industries, the essence of the Big Push.

According to Krugman: "Loosely, high development theory can be described as the view that development is a virtuous circle driven by external economies -- that is, that modernization breeds modernization. Some countries, according to this view, remain underdeveloped because they have failed to get this virtuous circle going, and thus remain stuck in a low level trap. Such a view implies a powerful case for government activism as a way of breaking out of this trap" (p.2). In most versions of high development theory, he continues, the self-reinforcement coming from "an interaction between economies of scale at the level of the individual producer and the size of the market" is combined with some sort of dualism such that the modern sector would have higher productivity, and therefore could pay higher wages, than the traditional one.<sup>7</sup>

Krugman argues that the pioneers of development economics stand out for their original insight into the problem of development, but also for a way of theorizing that was entirely different from that which was becoming dominant in economics. High development theory was in essence discursive and non-mathematical and from its inception a distinct and peculiar branch of economics. This approach, which Krugman regards as "archaic in style even for its own time" led to the virtual abandonment of high development theory from the economic analysis of development. Model building became the standard of the profession, and in the process the development theory of Hirschman and Myrdal became to economists "not so much wrong as incomprehensible" (2005, p.1). The fundamental insights into the problem ended up largely ignored.

Quite independently from the inclinations towards the use of formalization one could ask whether Krugman's (who for example not even mentions Latin American contributions) presents a fair account of development economics. The main point is how the original contribution can be updated and improved to remain vital for today's analysis of

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<sup>7</sup> "The story then went something like this: modern methods of production are potentially more productive than traditional ones, but their productivity edge is large enough to compensate for the necessity of paying higher wages *only if the market is large enough*. But the size of the market depends on the extent to which modern techniques are adopted, because workers in the modern sector earn higher wages and/or participate in the market economy more than traditional workers. So if modernization can be gotten started on a sufficiently large scale, it will be self-sustaining, but it is possible for an economy to get caught in a trap in which the process never gets going." (p.2)

development. It can be argued for instance that a promising direction is to expand on the relationship between economies of scale and the size of the market discussing explicitly the question of market formation and structural change. (Gualerzi and Cibils, 2014)

### **3. Hirschman and the strategy of economic development**

The point is that Krugman's basic model of high development theory, although useful, is oversimplified. It focuses on the big push argument, therefore on some notion of balanced growth and that is very much out of line with what for example Hirschman argues.

One of the prominent European development theorists, Albert Hirschman, is noted for the originality of his intellectual development, which includes a combination of economic and political theory. He is also possibly the best example of the adherence to a non-formalized, discursive approach to theorizing. His *Strategy of Economic Development* (1958) presents a criticism of many notions about development. It is apparent that the entire question of development, including the role of institutions, the public sector and government, depends on the very definition of the problem and the understanding of the development process as a process of inducement mechanisms rather than lack of prerequisites.

#### **3.1. The problem of development**

In the words of Hirschman the book is an attempt at elucidating the author's "own immediate experience in one of the so-called underdeveloped countries." Hirschman is referring to the years spent in Colombia from 1952 to 1956. He notes that various observations and reflections appeared to be "variations upon a common theme" which he sets out to investigate for "reinterpreting a variety of development problems" (p.vii).<sup>8</sup>

The "preliminary explorations" as the title of the first chapter reads really focuses on the nature of the problem of economic development, which is the search for a *primum mobile*, the key to the beginning of the development process. The development problem cannot be defined by what is missing, i.e. by a list of factors and conditions, of obstacles and prerequisites. The issue is not how long and sophisticated is this list. Hirschman shifts the focus from natural resources to capital, to entrepreneurial and managerial abilities and the early notion of human capital advanced by Schultz. The point, however, is that these factors, beginning with savings and productive investment, are "as much a result as a cause of development" (p.3). "When it was increasingly realized that economic

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<sup>8</sup> The very first sentence of the preface is a quote from Whitehead (1930): "The elucidation of immediate experience is the sole justification of any thought; and the starting point for thought is the analytic observation of components of this experience."

backwardness cannot be explained in terms of any outright absence or scarcity of this or that human type or factor of production, attention turned to the attitudes and value systems that may favour or inhibit the emergence of the required activities and personalities” (p.4). Although this is important and indeed “we shall ourselves be concerned with this line of enquiry” it is not the fundamental issue. The point of the suggested approach is that “development depends not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting for development purposes resources and abilities that are hidden, scattered or badly utilized” (p.5). Thus the need for a “binding agent” (p.6) as the key concept to get the development process started.

One of the characteristics of such a process is to realize that underdeveloped countries are latecomers; their development is bound to be “a less spontaneous and more deliberate process than was the case in the countries where the process first occurred” (p.8). Hirschman makes reference to Gerschenkron as one of the scholars that focused on the development process “as a deliberate attempt at catching up on the part of various groups of economic operators” (ibid.). The “relative degree of backwardness” with respect to the early comers, that is the countries in Continental Europe where industrialization had already taken off, conditions the development process.

With regards to what can set in motion economic operators to produce reforms and changes in institutions and value systems necessary for development, Hirschman diverges from the explanation offered by Gerschenkron. He questions in particular the idea that operators “really know all the time what needs to be done to shed backwardness ... and are therefore able to weigh the costs against the expected benefits of development” (p. 9). He notes: “What is a hindrance to progress in one setting and at one stage may be helpful under different circumstances.” The point here is that underdeveloped countries have little knowledge of the path ahead and what is needed to achieve the benefits of economic progress. It is only along the way “rather than a priori that they will determine which of their *institutions and character traits* are backward and must be reformed or given up” (p.10, italics added).

By ways of this clarification the nature of the “binding agent,” he argues, becomes clearer. In particular, it emerges as a “growth perspective” which includes the desire for economic growth but also “a perception of...the road leading toward it.” (ibid.) This perspective “can only gradually be acquired in the course of growth.” (p.11). The breaking of the



“interlocking vicious circles”, to use the expression by H. W. Singer (1949), takes place at the level where all the difficulties of human action “begin and belong, in the mind” (ibid.).

The preliminary exploration of the issue of development concludes by stressing that the investigation concerns the search of effective inducement mechanisms capable of improving and speeding up decision-making. This follows from the definition of the development problem as a deficiency not of any particular factor but “in the combining process itself” (p.25).

### **3.2. On balanced growth**

The assessment of the theory of balanced growth is a central element of Hirschman’s views on development. “...[I]t is only fair to warn the reader that I heartily disagree with the ‘balanced growth’ doctrine. In fact...it was the experience of finding myself instinctively much at variance with this theory that made me aware of having acquired a distinct outlook on development problems, which it might perhaps be worth while to explore systematically” (p. 50).

According to Hirschman, balanced growth theorists are Rosestein-Rodan, Nurkse, Lewis, and Scitovsky. Among other things the theory “stresses the need for different parts of a developing economy to remain in step to avoid supply difficulties.” In the version of “greater analytical interest...the requirements of balanced growth are derived from the demand side” (p. 51).<sup>9</sup> To avoid shortages of demand (Hirschman uses Rosenstein-Rodan’s example of a shoe factory and of his employees who are unable to buy all of its output) and therefore make development possible, the theory argues that “it is necessary to start, *at one and the same time*, a large number of new industries that will be each others’ clients...For this reason, the theory has now also been annexed to the ‘theory of the big push’ ” (ibid.).

“My principal point is that the theory fails as a theory of *development*.” Development, argues Hirschman, must be a process of change to a more advanced type of economy. But rather than dealing with the way the underdevelopment equilibrium can be broken, the theory superimposes a new self-contained modern industrial system to “an equally self-contained traditional sector.” This simply reflects the difficulty “to visualize how the ‘underdevelopment equilibrium’ can be broken into at any one point” (p.52). Hirschman labels that an “escapist solution” (p.52). For one thing it would require a large amount of

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<sup>9</sup> He notes that Rosestein-Rodan and Nurkse stress balance in demand, Scitovsky, and Lewis balance on the supply side.

those managerial and entrepreneurial skills that are in short supply. “In other words if a country were ready to apply the doctrine of balanced growth, then it would not be underdeveloped in the first place”(p.54). In reality “[w]e must recognize that there are tasks that simply exceed the capabilities of a society, no matter to whom they are entrusted. Balanced growth in the sense of a simultaneous multiple development would seem to be one of them” (Ibid.).

The other argument for balanced growth is the internalization of the external economies that a coordinated plan of investment would imply; “entrepreneurs in underdeveloped countries will invest far less than is profitable from the point of view of society” because they cannot appropriate the external economies generated by their investment” (p.55).<sup>10</sup> This is where the role of the state is important. However: “[t]he case for centralized investment planning... would of course be entirely convincing if it permitted production to be organized in such a way that *only external economies were internalized* while all the external diseconomies and social costs ...remained strictly external to the central authority or were negligible. ... but the question is: can it be done? Here again, the image...must have been that of a backward economic sector which would be pretty much left alone, and a brave new sector to be built from the ground up and in isolation” (p.56). This can be realistic in some cases. “*But in general economic development means transformation rather than creation ex-nov.*”(Ibid. italics added). In general development does imply many losses, as traditional ways of living and producing are disrupted.

In sum: “Internalization is likely to effect the pace of a country’s development unfavourably in some areas and favourably in others - the net effect is by no means clear” (p.61).

### **3.3. Development as a chain of disequilibria**

If the idea of a simultaneous start of many activities appears to be the pure model of balanced growth, there exists “a far less rigorous” but more realistic idea that “the various sectors of an economy will have to grow jointly in some (not necessarily identical) proportion” (p.62). That is to say, for the “pure” theory simultaneous growth is necessary to avoid a shortage of demand; the less rigorous version argues that some proportional growth is necessary to avoid supply bottlenecks (“supply or ‘structural’ considerations”, *ibid.*).

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<sup>10</sup> “In the opinion of Rosestein-Rodan, the pessimist anticipations by entrepreneurs are correct as long as they remain atomistic producers; in that of Scitovsky, they are incorrect since they are eventually going to be recipients of pecuniary external economies.” (Ibid.)

“In this form, the balanced growth theory is essentially an exercise in retrospective comparative statics” (Ibid.). Of course, argues Hirschman, growth has proceeded in this way, with growth “communicated from the leading sectors of the economy to the followers, from one industry to another, from one firm to another...the balanced growth that is revealed by the two still photographs taken at two different points in time is the end result of a series of uneven advances of one sector followed by the catching-up of other sectors. ... The advantage of this kind of seesaw advance over ‘balanced growth’ ... is that it leaves considerable scope to *induced* investment decisions and therefore economize our principal scarce resource, namely, genuine decision-making” (p. 63).

This raises another issue, namely, trusting market forces or public authorities to take decisions. “...Is the disequilibrium situation likely to be corrected, by market or nonmarket forces, or by both acting jointly? *It is our contention that nonmarket forces are not necessarily less ‘automatic’ than market forces.*” While this implies a discussion of the motivations of public authorities, what matters for our purposes is the conclusion: “There is no implication that any disequilibrium whatsoever will be resolved by some combination of market and nonmarket forces. But if a community cannot generate the ‘induced’ decisions and actions needed to deal with the supply disequilibria that arise in the course of uneven growth, then I can see little reason for believing that it will be able to take the set of ‘autonomous’ decisions required by balanced growth” (p.64).

Underlying the criticism of balanced growth is the idea of development as a chain of disequilibria. Whether or not they induce growth depends on circumstances that are of various natures. The point however is that this is a more realistic and operational way to look at development. Balanced growth appears a mistaken abstraction, in so far as it is inconsistent with the very process of development and de facto impossible.

#### **4. Imbalances and new markets: Transformational Growth**

The importance of unbalanced growth for Hirschman’s view of development has a striking counterpart in the modern theory of Transformation Growth, in fact a similar function in the process of development.

Transformational growth (Nell, 1998) is a long-term theory of the growth process that characterized the development of advanced industrial economies as a result of the operations of the market. It is centered on technical progress, structural transformation and the growth of demand. The focus is not on the market’s allocation function, but rather on

its mode of operation as an institution of change determining development with its inherent uncertainties and the periodical emergence of tendencies towards stagnation.

Transformational growth deals with many of the issues in modern economic theory and does so in an unconventional way. Although central to the question of long-term development the problem of growth and structural change remain largely outside the mainstream of modern growth theory.<sup>11</sup> In fact, Transformational growth it is the result of the critique of steady state growth. Steady growth, Nell (1982) argues, is not only virtually impossible, it would inevitably lead to stagnation. Transformational growth is then the process by which capitalism can, at least up to a certain point, sustain itself in the long-run: "To work properly the system must grow, and to grow it must continually transform itself through the introduction of new products and new processes, creating new life-styles, redistributing income and generating new markets" (Nell, 1988, p.159). Growth depends on a complex process of change, which involves innovation, income re-distribution and market expansion.<sup>12</sup> Market expansion necessarily involves changes in demand patterns and new markets. These ultimately account for a long-term growth of demand.

There are two major sources of new markets: the evolution of the social structure, with its effects on the structure of demand, and the development scenarios driven by the major facts of historical transformation or, in more abstract terms, by structural imbalances. For our present purposes we will concentrate on the second one.

This differs from what is customarily offered by economic theory, in which markets expand because of population and income growth -- a view of the growth process that can be accommodated within a steady state growth framework. Indeed, "there is another, more interesting way in which markets may expand...." (Nell, 1998, p.17), it has to do with transformation, which is not merely an additional feature of the growth process, but its very essence and engine.

Market expansion is the result of a secular trend underlying the growth of capitalist economies, associated with the "conquest of domestic production" (ibid. p.18) that takes place in the transition from craft and family-based production to modern, factory-based mass production. This secular trend it should be noticed combines market expansion with

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<sup>11</sup> The approach bears some fundamental similarities to that of John Cornwall (see, for example, Cornwall and Cornwall, 2001)

<sup>12</sup> "A capitalist industrial system, being inherently dynamic, has two and only two long run options - transformational growth or stagnation....These two choices tend to alternate, giving rise to the appearance of 'long waves' in economic life." (Nell, 1988, p.163)

the modernization of production (new technology), changing patterns of consumption (new products and new life styles) and urbanization. The reason of this sustained but unsteady market expansion ultimately is that markets take over what was previously accomplished through non-market procedures. We still need to explain: “how this invasion of the domestic sphere by the market began, and what forces kept it going”(p.18).

Here we come to the argument that makes structural imbalances the driving force of market expansion and therefore of growth. In general, it is an “imbalance in the economy”, a structural imbalance that which brings forward a response that fuels expansion. Such imbalances are rooted in historical facts, such as the enclosure movement during the early stage of capitalism, or in differences in the growth rates between sectors. In the case of the enclosures, the response was the creation of an urban-industrial setting, where new markets, and therefore new jobs, were created. “But this is not a one-time, exogenously caused imbalance; it is an imbalance which results from an ongoing process, an imbalance which will be reproduced if corrected” (p.19). Transformation is driven by imbalances, which are not the problem rather the very essence of the mechanism of expansion. Their reproduction creates the incentive and the opportunity for innovation of a specific type. Initially this will happen in a few industries and in a few places and these will become centers of innovation and investment. Historical long run transformation suggests that “[f]or growth to start up, the economy must become unbalanced ... [when] a structural imbalance is regularly reproduced it becomes a trend” (Nell, 1998, p.19). Transformational growth is the long-term tendency of the economy to evolve by changing its sectoral composition, and that affects the main variables of the growth process.

## ***5. Furtado and Latin American dependency theory***

### **5.1 Furtado and development**

The evolution of consumption patterns is one of the main aspects of the process of transformation and it is linked to the rise of new markets. While noting that it may require further analysis we can also note that it is left uninvestigated by most of development economics. One could indeed ask whether it could be a question at all for development. The exception is Celso Furtado. Furtado’s views on development appear to be open to such an investigation and that can be linked up at least as a working hypothesis to the question of the rise of new markets.

Furtado was profoundly innovative thinker on development issues, having worked at CEPAL in the prolific years of early structuralism, and eventually making substantial contributions to dependency theory.<sup>13</sup> According to Furtado, development economists should be able to answer three main questions (Boianovsky 2010, p.225): 1) What conditions and factors accounted for the advent of the first industrial economies? 2) What are the requisites for the advancement of an economic system from being stationary and non-industrial to being dynamic and industrial? 3) Under what conditions can economies bridge the gap separating them from those economies whose industrial development began between the end of the 18th and the first half of the 19th century?

Like many of his structuralist colleagues at CEPAL, Furtado's approach to economic analysis was critical of what Prebisch (1961) identified as mainstream economics' "false universalism". Furtado's methodology departed in two important ways from the mainstream. First, he advocated for a historical approach to analyzing economic realities. Second, his analysis was not limited exclusively to the evolution of economic data, it included social and political factors as well.<sup>14</sup> For Furtado, without an understanding of history and the social and political processes it was not possible to identify the specific problems of underdeveloped social formations. Furthermore, one cannot analyse a country in isolation, because that would lead on to mistaken conclusions. Furtado (1971) posits the necessity of studying the world system and how different subsystems (developed centre and underdeveloped periphery) interact. Without such an analysis, it is impossible to comprehend underdevelopment and the actions needed to overcome it.

It is clear that for Furtado, underdevelopment was not simply a case of being further back in the sequence of steps that lead to development, and therefore simply a matter of "catching up". Underdevelopment is a structural condition which resulted from the very development of capitalism on a global scale. Peripheral countries in the world capitalist system suffered of structural heterogeneity (exogenous technology) and dependency (due to elite cultural and consumption patterns).

Therefore, in the context of a dependent peripheral economy as just described, in order for development to occur, a productive structure needs to be created and developed. This, however, will never be the result of market forces, since it was precisely these forces that

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<sup>13</sup> For a comprehensive survey of Furtado's work, see Boianovsky (2010). Mallorquín (2007) is a chronological review of the evolution of Furtado's ideas, and Guillén (2003) provides an analysis of Furtado's views on development.

<sup>14</sup> This is clearly spelled out in Furtado (1966), Furtado (1971) and Furtado (1983), although it permeates all his writings.

let do peripheral dependence. In this way, the State becomes a key player, since through its revenue and spending structures it can have a substantial impact on the productive structure. According to Furtado (1968:244), “the main problem of underdeveloped countries is the selection is the choice of a strategy to alter structures, and not the elaboration of a conventional development plan based on quantitative political techniques”.

Finally, because Furtado’s methodology was not limited to the analysis of purely economic variables, but included historical and socio-political factors as well, he did not view development as an objective in itself, but as a means to improve the lot society as a whole, its institutions and its culture.

## **5.2. Industrialisation: Classical vs. Import substituting**

According to Furtado, in order to better understand the development possibilities and prospects of peripheral countries, it is necessary to understand the historical and socio-political processes that have taken place since the beginning of the current capitalist world system. Based on his historical analysis, Furtado made a clear distinction between the development of industrial capitalism during and after the industrial revolution in Europe and the US, and the capitalist development of peripheral countries. Based on this distinction, Furtado identified key differences between the development possibilities of peripheral countries, rejecting the Rostovian hypothesis of a linear set of “stages of development” which all countries would or could follow to achieve levels of industrialization and development comparable to Europe or the US.

For Furtado (1966), the development of capitalism in what is today the industrialised world was initially associated with a profound transformation in the production and supply of goods and services. Relatively stable wages, due to labour supply elasticity, resulted in the appropriation of social productivity gains by capitalists, who re-invested profits in productive expansion leading to an intensification of the transformation of the old social and economic structures.

As the labour surplus was increasingly absorbed and tended to disappear, labour was more able to challenge capital over the distribution of income. Capital’s response was to introduce labour-saving technical change. In this way, technology, which was an integral part of industrial capitalist development in the centre, acted as a social pacifier of sorts, moderating labour’s claims. Furtado (1966) concludes that in the centre’s capitalist economies, technology was a factor that contributed to growth and to social stability, while

at the same time allowing for rapid accumulation and moderate improvements in the distribution of income.

Therefore, in an integrated or homogeneous capitalist economy, that is an economy where the production of technology is an integral part of the economic system, there is an intimate connection between the direction of technical progress, the relative supply of the factors of production, and the social consensus on the rate of investment and saving, that is, the distribution of income.

Latin American industrialisation was fundamentally different from the original industrial capitalist development. Furtado characterises Latin America's development as a dynamic import substituting industrialisation, where investment was geared towards diversifying productive structures to locally satisfy demand. Local consumers would pay higher prices but global consumption would be higher.

Furtado highlights substantial differences between the two industrialisation processes. In the classical industrialisation process, productivity increases played a fundamental role displacing traditionally crafted goods thanks to the lower prices of industrial goods. This generated an environment that fostered entrepreneurship and business mentality. In import substituting industrialisation, import restrictions and difficulties act as an incentive to produce locally at higher prices. This process facilitates the formation of a class of monopolistic or oligopolistic producers who are eager to retain their privileges in later stages of the development process.

Additionally, technology used for the industrialisation process was imported, in other words it was exogenous to the development process. Furthermore, technology incorporated was designed according to relative factor availability in the industrialised countries and generally with a labour-saving bias. In other words, technology was a relatively inflexible and exogenous factor in the import substituting industrialisation process. The advantage was that it had already been developed elsewhere, but the disadvantage was that it did not provide the endogenous dynamism it provided during the classical industrialisation process. Factor absorption was thus not a result of relative factor availability, but of the incorporation of exogenous technology.

Under these conditions, factor markets do not act as orienters of investment decisions, with its obvious results on income distribution, resulting in the historic difficulties of underdeveloped countries with saving and investment. This situation becomes even more problematic when the import substituting industrialisation process embarks on capital good



production. Reduced and monopolistic markets result in high relative prices which then results in reduced ratio of investment per unit of saving. When the manufacturing sector absorbs these higher costs, productivity losses are propagated to the entire economy, resulting in a process that is the inverse of what occurred in classical industrialisation.

### **5.3. Culture and consumption: understanding dependence**

We come here to the point we want to call attention to, the role of culture and consumption, an aspect that has not received much attention. According to Furtado (1971), from the early stages of the development of the current world-system, following the patterns described above, an international division of labour was created such that central countries specialised in sectors in which technical progress had rapid penetration and peripheral countries specialised in activities based on their relative abundance of natural resources. As a consequence of this division of labour, with their primary product export earnings, peripheral countries imported consumption goods from the centre.

In this way, peripheral country elites adopted cultural patterns and behaviours, i.e., consumption patterns typical of central countries. In this way, the formation of a social group which adopted consumption patterns typical of central countries became a key factor in the dependent development of the periphery. According to Furtado (1971), import substitution tended to produce locally those goods consumed by elites that were previously imported.

Because technology is imported—and not developed in the periphery based on relative factor availability—structural heterogeneity is perpetuated, with its effects on persistent unemployment and a very unequal distribution of income. If salaries don't increase with productivity, and the capital-labour ratio is a function of the income of a minority that reproduces consumption patterns of the centre—where capitalisation is a lot higher—then the concept of “optimum” as used in neoclassical theory becomes meaningless.

The same consumption patterns copied by dependent subsystem elites, is a dynamic factor in the economies of the centre. However, in the periphery it rapidly reaches a saturation point that can only be overcome by the incorporation of new consumption patterns, a higher capital coefficient and more “modern” production processes resulting in higher productivity and higher incomes for the elites.

In this way, for Furtado “development” in the periphery becomes the diversification and expansion of the consumption of a small minority whose lifestyle is dictated by the cultural evolution in the countries of higher productivity. Or, put differently, the main factor behind

increases in productivity in dependent economies is the “imitative diversification” of behaviour patterns of the high income elites with scarce effects on life conditions for the majority of the population.

Under these conditions, the productive structure is not an outgrowth or extension of the traditional productive structure. Rather, production is set up to manufacture elite consumption goods that were previously imported. In this way, production is transplanted from the centre to the periphery, resulting in a decentralisation of manufacturing activity which is not the same as industrialisation. It is, rather, the localisation of manufacturing activities in the periphery while activities linked to conception of technology, production process and the goods themselves remains in the centre.

It seems therefore appropriate to consider how consumption patterns interact with market expansion identifying one of the important question for emerging economies as the process of development proceeds.

## **6. Concluding remarks**

Admittedly, this brief examination of theories is not sufficient to derive any strong conclusion. However, it quite clearly sets up a resercah agenda that can bring development economics to face the questions of development more than 40 years after the foundations of the “sub-discipline” were laid out. In particular, we want to argue that the development of the insights contained in the work of Hirschman and Furtado depend in some fundamental way on a view of economic development driven by structural change and new markets. The penetration of technology and modern production into the “third world” has now run a long course and the question is really what are the characteristics of a new phase at the world scale. How is that differently articulated at the center and in the periphery?

Though highly abstract, the notion of Transformational Growth can serve well this purpose, precisely for its focus on the process of structural evolution and the rise of new markets in the process of economic development. Transformational growth is not specifically directed to analyzing developing economies. Historical circumstances and the specific questions of development are absent, but the general theory of transformation might be useful to re-address the question of today’s development trends.

We have shown that there is indeed a fundamental similarity between Hirschman’s chain of disequilibria and the mechanism by which structural imbalances drive the process of

innovation and new markets creation. In fact, the idea of new markets arising from the process of transformation addresses the question of the interdependence between investment decisions and market size, which lies at the core of the Big-push, but is also important – without any presumption of balanced growth – for Hirschman’s backward and forward linkages. At the same time the importance of the evolution of consumption for the formation of new markets suggests a new and complementary perspective on the analysis of developing economies. It allows a reconsideration of the views, such as those of Furtado, in which consumption patterns are explicitly considered. While Hirschman had no conception of dependency, for Furtado consumption patterns evolution is an important aspect of dependent development.

Clearly there is much more to the project of rethinking development economics in the context of the globalized world economy.<sup>15</sup> Both Hirschman and Furtado’s views on development afford more elaboration. The analysis above should be seen as a first step in pursuing the goal of bringing back structure and dependency into the analysis of development.

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<sup>15</sup> This is the title of a book edited by Ha-Joon Chang (2003).

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