Analysis of the theory of unbalanced growth

Do you think that a less developed /developing country should always follow the path of balanced growth? If yes, why and if not why not? Substantiate your arguments with the examples drawn from experiences of development in developing countries.

Answer:

When Rostow was making attempts to place economic development within a progressive framework, it lead to a debate in the 1950's and the 1960's which was primarily fixated on whether development efforts should focus on specific economic sectors within the countries or whether it should be carried out in all major sectors of the economy namely the manufacturing sector, agriculture and the service sectors.

In this very context, economistRagnar Nurksepropounded that development efforts should make synchronized use of capital in order to develop an extensive range of industries in the nations. According to his beliefs, an Intensive overall effort was of utmost importance, which would ultimately drive the developing or the underdeveloped nations away from thevicious circle of povertywhere the limited supply of capital originated in the first place, due to the low saving rates. In underdeveloped countries, the vicious circle of poverty is responsible for the small size of the market for their goods. Nurkse was an " export pessimist" and he believed that the finances required to make investments in less developed countries should originate from their own domestic territories. He did not give any importance to the promotion of exports. The balanced growth approach also supports the big push theory which promotes the channeling ofbulk capital to all the sectorsat once owing to the belief that gradual investment in the sectors is not reasonable. Investments should be carried out in a number of industries that mutually support each other, in order to enlarge the size of the market. Investments in the sectors should be made simultaneouslysuch that it brings about a positive drive to overcome the significant barriers to development. With the adoption of this strategy, there emerges new opportunities to distribute the fruits of development more evenly throughout the society and to cure the plights of inequality, inflation and unemployment of resources. On the other hand, the theory of balanced growth has been largely criticized as it ignores the economic notions of all round benefits ensuing from specialization in production and development processes. Since it takes place within a closed economy and is applicable predominantly to a private enterprise system rather than specialization and trade, the doctrine contradicts the whole principle of comparative advantage. Also, it emphasizes on the complementarity of markets for final goods and primary consumer goods as a stimulus to invest and ignores the immediate goods market. It has been stated to be unrealistic as it expects a country which is developing or is underdeveloped to make bulk investments in all the sectors simultaneously without considering the aspect that if a country had enough resources to invest in all the sectors of the economy all at once, it would not classify as underdeveloped or developing in the first place. Also, the theory makes an impractical assumption that all nations would start from the same zero point, whereas in reality such is not the case. Certain economies are bound to have certain historical strengths and different investment capacities which may vary. This theory has been massively dismissed, when in the 1960’s and 1970’s the actual progress of LDC’s reflected growth without any significant attempt to synchronize the simultaneous investments in all the sectors as a result of which these nations continued to remain comparatively underdeveloped.

Contrary to this theory, some theorists also advocated a strategy of investment only in selective sectors as an attempt towards encouraging growth in the developing countries. EconomistAlbert O. Hirschmanput forth the idea of adoptingunbalanced investmentsin specific economic sectors in order to complement the imbalances that already appear to exist within the economy of a nation as such. The unbalanced growth strategy aims at eradicating the scarcities in underdeveloped nations by adoptinginduced investment decision making. Hirschman contradicted the balance growth theory and argued against it, stating the most obvious that the LDC'S do not have access to adequate resources to adopt and implement a balanced, big push investment strategy. Instead, he proposes that investments should be carried out in strategically selected economic areas, such that there is growth in other sectors owing to thebackward and forward linkagesthat are established, which will further lead to new investment opportunities, thereby paving the path for further economic development. Backward linkages bring about new investments in the input industries, whereas forward linkages do the same in the sectors that purchase the output of the selected industry . Deliberate unbalance, tensions, disproportions and disequilibria brought about in the economy is the most effective strategy to achieve economic growth in an underdeveloped or developing country. Thus the economy is able to gradually move from the track of anunbalanced growth pattern to that of balanced growth. Acknowledging all the advantages of the unbalanced growth strategy, this theory also has its shortcomings. The theory makes an inherent assumption that the success of the growth process can be traced down to external trade and foreign aids. This further upsurges the uncertainty of the growth process. The theory is also seen to emphasize on development through industrialization without taking into consideration the significance of agriculture. Being concentrated on only a couple of industries, there might be situations where the resources are not appropriately utilized. Also, some sectors of the economy will be witnessed to grow at a faster rate while other sectors will remain neglected. This raises a question as to whether investment has been carried out in the correct sectors owing to the aspect that all the sectors of the economy are not invested upon. Therefore, in this particular scheme careful understanding of the situation of each country needs to be carried out, in order to determine what investment in which sector should take place as means to reach an ultimate balance among all the investment sectors in the economy.

The theory of unbalanced growth appears to be an ideal strategy proposed by Hirschman at pointing out the ways to accelerate economic development in developing and underdeveloped nations in spite of all its flaws and disadvantages. As we know, with unplanned unbalanced growth there is absolutely no assurance against unemployment, inflation and unequal distribution of income and the strategy is recognized as adoctrine of laissez-faire, which indicates that there is an absence of safeguards against the socially divisive consequences of change. Howsoever, it still appears to be more realistic and feasible than the balanced growth strategy as it tries to take into account almost all the minute aspects of development planning. As a matter of fact, even the various inducements, obstacles and resistances to development are taken into consideration in their appropriate perspectives. Unbalanced growth generates externalities. The existing externalities are explored while generation of the fresh ones take place. It promotes the growth of strategic industries and thereby, stimulates the growth of other industries. Also, there are technical complementaries which stimulate the growth of related industries along the lines of this strategy. Since investments in the form ofSocial Overhead Capital (SOC)andDirect Productive Activities (DPA)cannot be taken into consideration simultaneously in less developed or developing countries, owing to the obvious lack of resources, the theory proposes that focus should be established on either one of the two, and as a result of which the other one would be automatically stimulated. In order to achieve this, the growth of the economy should take place either byunbalancing the economy through SOC; by promoting the growth of SOC which would stimulate investment in DPA, or byunbalancing the economy with DPA; such that the investment made in DPA would eventually press for investment in SOC. It is through this process of linkages commonly known as the “ linkage effect”, that the economic growth will ultimately take place. Development should progress with the aim of targeting projects which will have the largest total linkage. However, the main problem can be narrowed down to figuring out the kind of imbalance that is expected to be the most beneficial depending upon the economy of the nation.

Hirschman pin points theabsence of interdependence and linkagein less developed countries as a result of which the primary production activities for exports have very little development effects on the economy of an underdeveloped country. He therefore puts forth a tactic and advocates the setting up of “ last stage industries first” in order to resolve the problem. He stresses onexport promotion and import substitutionand favors a mixed economy owing to the fact that unless the SOC pathway of economic development is adopted by the state, it will not encourage any form of private investment in DPA, as private investments in underdeveloped countries fail to create the necessary economic surplus that is a prerequisite for development to continue and even for the sustenance of losses.

It has been seen, that despite the weaknesses of theunbalanced growth strategyas illustrated in the beginning of the report, the technique has come to be recognized as suitable for the development of underdeveloped and developing countries. When Joseph Stalin ruleddeveloping Russia, it was one of the first countries to adopt this strategy and by implementing this technique it succeeded in accelerating its economic growth rate within a very short period of time. In the current scenario Russia is recognized as a developed country. Along the same lines, India adopted this strategy with the Second Five-Year Plan. In India, investments in heavy industries were kept at a high level during the five year plans and simultaneously there were consistent efforts made towards stepping up the production of consumer goods. But there was no attempt made to keep the levels of consumption low in order to produce a large economic surplus. Also, there is evidence which suggests that India did not follow the typical pattern of industrialization. High technology industries flourished as opposed to the growth in the basic manufacturing sector which was lagging. The promotion of the high technology sector has had a negative impact on the manufacturing sector as well as on the aggregate income of the country. Instead if resources were directed towards infrastructure, it would have yielded benefits for all sectors and would have increased the aggregate income as well. Therefore, the unbalanced growth strategy in India did not meet with great success.

EvenChinaadopted the unbalanced growth strategy and as a matter of fact China's unbalanced growth is an investment driven model due to which it has been predicted that growth in china will not be sustainable unless it adopts a more consumption driven model. China's growth pattern apparently mirrors that of other successful emerging South East Asian economies namely Japan, South Korea, Taiwan and Singapore. These countries were successful in the last fifty years in progressing from the middle income group to advanced economies. This transformation was characterized by long periods of high levels of investment after their economic take off, which corresponds to China's growth trajectory. Unfortunately, many of the other developing economies failed to make it to the upper stage of development or are caught up in the " middle income trap". But due to China's high levels of investments in the last few years which had managed to reach a level, higher than that of any other nation, it appears that China should adopt a rebalancing growth strategy, like other the countries after their considerably lengthy periods of high investment, which would mark the end of its period of unbalanced growth. However, it looks like China has to go a long way in order to catch up with the economies of the advanced countries in terms of productivity.

WhenJapan and Koreainternalized the unbalanced growth strategies, they concentrated their national resources on some strategically chosen industries and targeted principally forimport substitution. Japan's economic growth picked up pace, led by the electronics industry, heavy and chemical industries. As a matter of fact, both Japan as well as Korea, witnessed the growth of an independent national economy through the implementation of import substitution in the heavy and chemical industries as well as the ' high tech' industries.

This strategy was adopted by yet another developing country in Africa calledZambia. Zambia's excessive dependence on its mining exports is an apt instance of unbalanced growth which eventually proved to be more of a high risk strategy and hence, was not sustainable. Therefore, Zambia inherited an economy that took to the unbalanced growth strategy, but was unsuccessful in balancing it within the correct time frame.

We see, that most of these developing countries adopted the unbalanced growth strategy, but only a few met with success. However, in this respect the balanced growth strategy with its limitations should not be completely dismissed as both these strategies appear to converge at certain points. Both the strategies consider the existence of a private enterprise system that is heavily grounded on market mechanism under which they function. Both the theories disregard the importance of supply limitations and supply inelasticities. Also, both the doctrines assume interdependence which vary in their degrees. This interdependence is seen in balanced growth, when the development of one sector is heavily dependent on the development of the other sectors whereas, in unbalanced growth strategy the economy progresses towards economic development by the creation of tensions, disproportions and disequilibria thereby attaining balanced growth. Thus, both these strategies are based on the interdependence that is established among the different sectors of the economy .

The choice between adopting the balanced growth strategy and the unbalanced growth strategy is a difficult one. None of the strategies are perfect and both have their own advantages and limitations. Although, keeping in mind the scarcity of resources that a developing country faces, common knowledge directs the developing or underdeveloped nation to adopt and implement the strategy of unbalanced growth. Even under this strategy, it is beneficial if the nation invests on the SOC first, which will subsequently encourage investments in DPA, which would direct the economy further towards the path of balanced growth. In theIndian contextitself we can see that unless SOCs such as power, transportation irrigation etc. are developed, the development in the industrial, agricultural and commercial sectors will automatically be retarded. When this strategy is being adopted by developing countries, it is crucial that they should try their best to control the evils of inflation and balance of payments.

Nevertheless, we see that these strategiesshould not be considered as an alternative to the other, as they seem to complement each other. By implementing the unbalanced growth strategy as the means, the developing or the less developed nations can attain balanced growth, which is the ultimate aim.

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