Prof S. S. Haider

DI Hons

Analyse the classical concept of eco. development. To what extent it is applicable to an U.D. country?

Eco. development is not a new concept. Over the years in the past social scientist has been concerned with eco. development, but they did not evolve a systematic theory of economic growth. The Mercantilist did much to augment the material growth of a nation. The physiocrats attacked them for narrowness of their definition of wealth. It was however A. Smith who addressed himself to the general problem of how to create a social and political framework that would encourage sustained eco growth.

The classical theory can be explained as follows. The classical economists believe that in the existence of an automatic free market perfectly competitive economy which is free from govt interference, it is the invisible hand which maximise the national income.

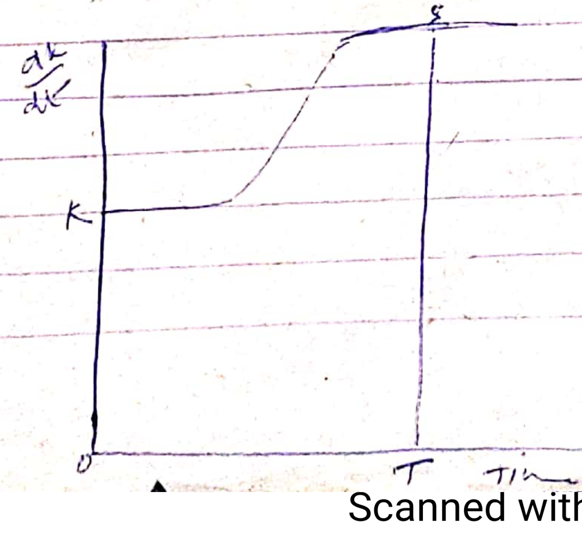
All classicist regard capital accumulation as the key to eco progress. They, therefore, lay emphasis on large savings. Only capitalist and landlords are capable of savings, according to them. According to classicist, profit induce investment. The larger the profit the greater the capital accumulation and investment. Profits do not increase continuously. They tend to decline when competition increases for large capital accumulation among capitalist. The reason according to Smith is increase in wages due to competition among capitalists, where as according to Ricardo when wages and rent rise with the increase in the price of corn, profits decline.

All Classical economist visualise the Stationary State at the end of the process of capital accumulation. When once profits starts declining this process continue till profit becomes zero, population and capital accumulation stops increasing and the wage rate reaches the subsistence level.

Malthus establishes a unique correlation between population growth and food supply. According to him if the growth of population were left uncontrolled, it would outrun the growth of capital and hence the means of subsistence. Both Ricardo & Malthus see a growing population and a declining growth of capital through the operation of the law of diminishing return as ultimate check to economic development.

In broad outline, the classical theory of economic development may be stated thus: Suppose an expected increase in profits brings about an increase in investment which adds to the existing stock of capital and to the steady flow of improved techniques. This increase in capital accumulation raises the wage fund. Higher wages induce an accelerated population growth which causes the demand for food to rise. Food production is raised by employing additional labour and capital. Reduction in profits implies reduction in investment, retarded technological progress and slowing down of the population growth and capital accumulation. In the classical model the end result of capitalist development is stagnation. ...... This stagnation resulted from the natural tendency of profit to fall and the consequent choking off of capital accumulation.

The classical Theory is explained in terms of the figure where time is taken on the horizontal axis and the rate of capital accumulation $\frac{dk}{dt}$ on the vertical axis. The economy grows from K to S during the time path T. After T, the economy reaches the stationary state linked to S where further growth does not take place because wages rise so high that profits become zero and capital accumulation stops.



Criticism :— Ignore Middle class — The whole analysis was based on the socio economic environment prevailing in Great Britain. It assumed the existence of a rigid division of society between capitalist and labourers. It neglect the role of the middle class which provided the necessary impetus to eco. growth.

(2) Neglect Public Sector :— To the classicist the perfect competition and the institution of private property were the essential prerequisite for eco. development. They however failed to realise the important role which the public sector has assumed in accelerating capital accumulation in recent years.

(3) Less Importance to Technology :— One of the important lacunae with the classical Theory is the part played by Science & Technology in development. Increase in productivity resulted from extra capital & increased division of labour. A. Smith realized the importance of improved technology in economic development. According to him, technology lead to division of labour and the expansion of market. It was, however, Ricardo who pointed out that improved technology in the industrial field led to displacement of labour and other adverse consequences. The classicist failed to visualise the important impact that Science & technology had on the rapid eco. development of the new developed nations.

(4) Wrong notion about wages & Profit :— Wages have not tended to be at the subsistence level. There has been a continuous increase in money wages without a corresponding decline in profit rates and the mature economies have not reached the stage of economic stagnation. Both Ricardo & Malthus have been scoffed at as false prophets in the light of the economic development of the western world.

(5) Unrealistic Growth Process :— The classical Theory assumed a stationary state in which there was change, but around a point of eql. There was progress but steady & continuous like a tree. This is however not a satisfactory explanation of the process of eco. growth. For economic growth, as it is understood today does not proceed steadily & continuously but by fits & starts.

Its Applicability to U. D. Countries :—

The Smith Theory of eco. development has limited validity for U.D.Cs. In such economies the size of the market is small. As a result, the capacity to save & inducement to invest are low. The size of the market is determined by the volume of production. This in turn depends on the level of income. Capacity to buy means capacity to produce here. Any productivity to a certain extent depends on the degree to which capital is employed in production. Since the size of the market is small, productivity is low and low productivity implies low level of income. The low level of income results in small capacity to save & inducement to invest & they keep the size of the market small. To use the expression the level of real income is low in underdeveloped countries but the propensity to consume is very high & every increase in income is spent on food products. Little is saved & invest. The volume of production remain at low level. Consequently, the size of the market remains small.

Moreover, the political social & institutional assumptions underlying Smith Theory are not applicable to the conditions prevailing in U.D.Cs. Laisser Faire has lost its significance in such economies. Competition has been gradually replaced by monopoly which has tended to perpetuate and strengthen the vicious circle of poverty. Therefore development is possible through govt intervention rather than through a policy of laisser Faire.

Schumpeter explained Smith's approach to eco. development in these words, " Taking institutional, political and natural factors for granted, Smith starts from the assumption that a social group — we may call it a nation, will experience a certain rate of growth that is accounted for by increase in number and by saving. This induces the widening of market which in turn increases division of labour and they increases productivity ... In this theory the economy grows like a tree.

According to Smith, this process of growth is cumulative when there is prosperity in manufacturing industries and commerce it leads to capital accumulation, technical progress, expansion of market etc. But this process is not endless. It is the scarcity of natural resources that finally stops growth. Smith wrote, in a country which had acquired that full complement of riches which the nature of its soil and climate and its situation with respect to other countries, allowed it to acquire which could therefore advance no further and which was not going back, both the wages of labour and the profit of stock would probably be very low. Investment starts declining and in this way end result is the stationary state. When this happens capital accumulation stops, population becomes stationary, profits are the minimum, wages are at the subsistence level, there is no change in per capita income and production and the economy reaches the state of stagnation.