Case Study 3

Schools of Thought in Context: South Korea and Argentina

A closer examination of two countries confirms the conclusion that each of the first four broad approaches to development—stages of growth, structural patterns of development, dependence, and neoclassical—provides important insights about development processes and policy. South Korea and Argentina are reasonably well matched for such a comparison; for example, both are midsize in population (41 million in Argentina and 50 million in South Korea in 2011), and both were long classified as middle-income countries. But South Korea, now designated by the World Bank as a high-income country with about $31,000 PPP in 2008, has nearly double the per capita income of Argentina, with about $17,000 PPP in 2011, whereas 30 years earlier the reverse was true. Can the four classic approaches to development explain this reversal?

South Korea

Stages of Growth South Korea confirms some linear-stages views, albeit in a limited way. Its share of investment in national income has been among the highest in the world, and this is a crucial part of the explanation of the nation's rapid ascent. To understand just how rapid this ascent has been, consider that the country did not even rate a mention in Rostow's *Stages of Economic Growth* in 1960, when the book was published, and few of the "preconditions for takeoff" were in place. Investment has been very high since then, but as a share of GNI, the investment ratio, at 15%, was still below takeoff levels in 1965. Yet it rose dramatically to 37% of GNI by 1990 and remained close to 40% in the 2000–2007 period (though the ratio has fallen in the last few years). Still, South Korea's ascent has seemed to epitomize Rostow's notion of an economy in the midst of a "drive to maturity," well on its way toward mastering the range of currently available technologies; and appears to be entering an "age of high mass consumption."

Rostow claimed that maturity is attained some 60 years after takeoff begins, but he never denied unique experiences for each country, and it may well be that the gap between traditional and advanced technology can actually be crossed more quickly at later stages of development. The larger the productivity gap is between countries, the quicker income can grow once takeoff has been achieved. South Korea certainly meets the "maturity" criterion of becoming integrated with the world economy through new types of exports and imports. Although the fact that India, rather than South Korea, was picked by Rostow for takeoff shows the limits of the predictive powers of the stages theory, the case of South Korea nonetheless offers some confirmation of their value.

Structural Patterns South Korea also confirms some patterns-of-development structural-change models. In particular, South Korea's rise over the past generation has been characterized by rapidly increasing agricultural productivity, shifts of labor from agriculture to industry, the steady growth of the capital stock and of education and skills, and the demographic transition from high to low fertility. These changes have occurred while South Korea's per capita income has grown by more than 7% annually for the whole 1965–1990 period. Even in the 1990–2002 period, as a more mature economy and in the face of the Asian financial crisis of 1997–1998, the economy grew at a 5.8% rate. In 2002–2011, it grew at less than 4% on average, still substantially higher than most other high-income countries. In the late 1940s and 1950s, South Korea carried out a thoroughgoing land reform, so agriculture was not neglected;

but otherwise its growth through rapid expansion of the percentage of the labor force in industry has broadly conformed with the Lewis model of development. After about 1970, productivity growth in agriculture also increased rapidly, owing in part to a successful integrated rural development program.

Dependence Revolution But South Korea poses a serious challenge to the dependence revolution models. Here is a poor country that became tied in with the international economy: It was strongly dependent in international relations—it was a Japanese colony until 1945 and thereafter wholly dependent on maintaining the goodwill of the United States for defense against invasion by North Korea. It received a large part of its national budget in the form of U.S. aid in the 1950s and both exported and imported a great deal from developed countries, especially the United States and Japan. The shape of the nation's development was thus "conditioned" in large part by export opportunities to developed countries, and dependence theory would predict that retarded development opportunities should result. Yet South Korea today is an OECD member and is widely considered a "graduate" to developed-country status. Of course, dependence theorists could and do claim that South Korea is an exception because of the magnitude of aid it received and the self-interests of the advanced countries in seeing its full successful development because of its role as a bulwark against communism. And the Korean government pursued some particular policies that the dependence school would by and large applaud, including carrying out an extremely active industrial upgrading policy, sharply limiting the role of multinational corporations and deliberately establishing indigenous industries as an alternative, and using debt rather than direct foreign equity investment to finance extraordinary levels of investment. South Korea also implemented one of the most ambitious land reform programs in the developing world and placed strong emphasis on primary rather than university education, two policies of exceptional importance. But this does not explain how South Korea was able to adopt such policies to break out of dependence in the first place.

Neoclassical Counterrevolution South Korea likewise poses a strong challenge to the neoclassical counterrevolution models. The nation was highly interventionist at home and in international trade, with the government making extensive use of development planning, using a wide range of tax breaks and incentives to induce firms to follow government directives and interventions, setting individual company export targets, orchestrating efforts in various industries to upgrade the average technological level, coordinating foreign technology licensing agreements, using monopoly power to get the best deal from competing multinationals, and generally inducing firms to move rapidly up the ladder of (dynamic) comparative advantage (see Chapter 12). These policies addressed real technology and skill-raising market failure problems of development, and at least prior to the 1997 Asian currency crisis, from which Korea quickly recovered, very few cases of glaring government failure can be pointed to in this experience. Of course, it does confirm that firms respond to economic incentives. But it may also be claimed with at least equal force that South Korea provides a compelling example of government's role in overcoming coordination failures, as examined in Chapter 4 and applied to South Korea in the end-of-chapter case study for Chapter 12.

Argentina

In contrast, for Argentina, stages and patterns theories illuminate relatively little economic history, whereas the dependence revolution and neoclassical counterrevolution theories together offer important insights. It remains unclear whether Argentina has now relaunched onto a new growth episode following its 2002 default, as growth has been erratic, foreign exchange reserves falling, and political uncertainty returning.

Stages of Growth The history of Argentina poses a strong challenge to the linear-stages approach. Rostow defined *takeoff* as "the interval when the old blocks and resistances to steady growth are finally overcome.…Growth becomes its normal condition." In 1870, Argentina ranked 11th in the world in per capita income (ahead of Germany); today, it is not even in the top 60. Although Rostow said that in determining a country's stage, technology absorption, not income per inhabitant, is what matters, he dated Argentina's preconditions for takeoff as an extended period before 1914 and concluded that takeoff "in some sense" began in World War I, but "in the mid 1930s…a sustained takeoff was inaugurated, which by and large can now [1960] be judged to have been successful," concluding that "in Latin America the takeoff has been completed in two major cases (Mexico and Argentina)." Rostow attributes the fact that preconditions were there for some time before takeoff to excessive import of foreign capital over too long a period without increasing domestic savings. (But South Korea was also a heavy foreign borrower until recently.) Argentina certainly met Rostow's criterion of developing manufacturing sectors at a rapid rate.

But now let's look at what happened in Argentina since Rostow put the country forward as an example. According to World Bank data, Argentina had a *negative* growth rate throughout the 1965–1990 period, and in the 1980s, domestic investment shrank at a −8.3% rate, falling back well below Rostow's threshold takeoff investment levels. Although Argentina grew at 3.6% in 1990–2001, it defaulted on its debt in 2002, and the economy shrank 11%, followed by a recovery and resumed if erratic growth. Argentina's share of investment in GDP from 2000 to 2007 was 17%, well under half that of South Korea. Like many other Latin American and African countries in the 1970s, 1980s, and 1990s, Argentina demonstrated that development progress is not irreversible and that sustained growth can come to an end. It remains unclear whether Argentina has now relaunched onto a new growth episode following its 2002 default, as growth has been erratic, foreign exchange reserves falling, and political uncertainty returning.

Structural Patterns Argentina did exhibit many of the usual structural patterns of development as agricultural productivity rose, industrial employment grew (albeit slowly), urbanization took place, fertility fell, and so on. But the fact that many structural regularities of development were observed even as living standards in the country stagnated illustrates some of the shortcomings of relying too much on selected pieces of data without the assistance of guiding theory on how the parts fit together.

Dependence Revolution In contrast to South Korea, the case of Argentina offers some vindication for dependence theories in that the country relied to a large extent on exporting primary goods, and the real prices of these goods fell compared to imports. Multinational corporations played a large role, and Argentina was unable to create its own viable manufacturing *export* industries, ultimately having to submit to stringent structural-adjustment programs, sell state industries to foreign companies, and other constraints. Dependence theorists can claim with some justification that Argentina's conditioned development fell victim to developed-country economic interests, especially those of British and American corporations.

Neoclassical Counterrevolution But Argentina also offers some vindication for neoclassical counterrevolution theory in that faulty interventionist restrictions, inefficient state enterprise, bias against production for exports, and unnecessary red tape ended up hurting industry and entrepreneurship. Government policy consistently seemed to support privileged interests rather than broad goals of development, and government failure was usually worse than market failure in the country. In the mid-1990s, a large-scale liberalization and privatization program seemed to be beginning to reinvigorate growth in Argentina. Unfortunately, by 2002, four years of recession culminated in economic implosion as the economy collapsed under the weight of rising internal fiscal and external trade deficits, caused in part by the linking of the peso to a strong U.S. dollar. Dependence theorists claimed vindication. The recovery and comparatively rapid growth since 2004, despite Argentina's 2002 debt default, showed that single explanations for development success and failure are rarely adequate. Yet Argentina's economic recovery remains vulnerable—for example, growth dropped from about 9% in 2010 and 2011 to under 2% in 2012—and political institutions remain somewhat unsettled.

Summary

It is interesting that as South Korea provides a challenge to both dependence and neoclassical theory—the starkest opposites in many ways—Argentina can be viewed more as a vindication for these two theories. And whereas South Korea serves more to confirm linear stages of growth and conclusions about structural patterns of development, Argentina poses challenges to their universal importance. Yet each of these four approaches has added something vital to our understanding of development experiences and prospects in just these two countries. South Korea also illustrates the role of government in overcoming coordination failures, while Argentina illustrates how government can become part of a bad equilibrium, topics explored in depth in the next chapter. ■

Sources

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Concepts for Review

Autarky
Average product
Capital-labor ratio
Capital-output ratio
Center
Closed economy
Comprador groups
Dependence
Dominance
Dualism
False-paradigm model
Free market
Free-market analysis
Harrod-Domar growth model
Lewis two-sector model
Marginal product
Market failure
Market-friendly approach
Necessary condition
Neoclassical counterrevolution
Neocolonial dependence model
Net savings ratio
Open economy
Patterns-of-development analysis
Periphery
Production function
Public-choice theory
Self-sustaining growth
Solow neoclassical growth model
Stages-of-growth model of development
Structural-change theory
Structural transformation
Sufficient condition
Surplus labor
Underdevelopment

Questions for Discussion

1. Explain the essential distinctions among the stages-of-growth theory of development, the structural-change models of Lewis and Chenery, and the theory of international dependence in both its neo-Marxist and false-paradigm conceptualizations. Which model do you think provides the best explanation of the situation in most developing nations? Explain your answer.
2. Explain the meaning of *dualism* and *dual societies.* Do you think that the concept of dualism adequately portrays the development picture in most developing countries? Explain your answer.
3. Some people claim that international dualism and domestic dualism are merely different manifestations of the same phenomenon. What do you think they mean by this, and is it a valid conceptualization? Explain your answer.
4. What is meant by the term *neoclassical counterrevolution*? What are its principal arguments, and how valid do you think they are? Explain your answer.
5. Given the diversity of developing countries, do you think that there could ever be a single, unified theory of development? Explain your answer.
6. Is the neoclassical, free-market theory necessarily incompatible with dependence theory? How might these two approaches work together?
7. In what ways do developing countries depend on rich countries? In what ways is the opposite true?