Chapter 3
Economic Growth, Sustainable Development, and the Role of Markets

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ABSTRACT

This chapter tracks the long path that Development Theory has traversed over the last century. Its origin traces back to the notions of economic growth and development and eventually reached a stage where governments and academics are more concerned with more holistic notions of development than merely growth. Sustainable development has become the most important notion of the day and provides a more comprehensive definition of development, linking ecological services and quality of life with economic growth. Such a paradigm shift in less than a century is no less than a revolution. Expectedly, this shift has been marked by cognitive dissonance, bitter debates, and scholastic antagonism. This chapter traces the story of how the road has been traversed and the shift achieved. It highlights the various theories of economic growth and development and focuses on the debates among economists that have helped the discipline traverse this long way. Finally, this chapter talks of markets. While it has often been understood that markets can promote economic growth, this chapter further emphasizes how markets, under enabling conditions, might be the right catalysts to promote sustainable development.

THE DAYS OF CLASSICAL POLITICAL ECONOMY…

With political economy evolving out of the writings of Adam Smith and David Ricardo, the scope of economics as a discipline got defined in the confinements to find and explain the "nature and causes" of economic development. The scenario is neither so simple nor so comfortable for modern economists; it has always been considered a maverick field; lurking somewhere in the background but not really thought of as "real economics"—rather an amalgam of sociology, anthropology, history, politics, and all-too-often, ideology.

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Though it has often been claimed that economic development as a branch of economic science emerged only in the ’50s, there is no doubt that the notion of development existed even in the classical economic thought processes. The recognition of development economics as a discipline over the past 50 years earmarked the changes in our understanding of development. The wealth of experiments so far has revealed that there are clearly no sure-fire formulas for success; if there were, there would have been many more success than what there are today. Economic theory has, in fact, evolved to account for both successes and failures.

Nonetheless, few of the greatest economists actually ignored it outright. The Classical School, starting with Adam Smith, was concerned with “economic development.” However, their notion of economic development was quite different from what is defined as development today by development theorists. This difference gets reinforced in Smith’s *Wealth of Nations*, and Ricardo’s *Principles of Taxation*, and goes on *till* Schumpeter’s classic *Theory of Economic Development* (1911). The German Historical School—and its English and American counterparts—could very well be deemed as part of development economics. It was thoroughly geared towards the theory of economic growth.

However, the primary focus of economic research remained confined to developed nations till the 1930s. It was Colin Clark’s quantitative study in 1939 that made economists realize that most of humankind did not live in an advanced capitalist economic system. Yet, the early concern was still Europe; namely, post-war European reconstruction and the industrialization of its eastern fringes as exemplified by the pioneering article of Paul Rosenstein-Rodan in 1943 and Kurt Mandelbaum’s book in 1947. It was only some time after the war that economists really began to show their concerns for Asia, Africa, and Latin America.

To this end, decolonization was an important catalyst. Faced with a plethora of new nations whose standards of living and institutions were so different from the European way of life, modern development theory—by which we mean the analysis of not only growth but also of institutions that could induce, sustain, and accelerate growth—began in earnest to change its focus and rearrange its referential. After the Second World War, academes began to think of ways and means of effectively dealing with poverty and destitution that heavily weighed upon two-thirds of the human race (Pakdaman 1994).

The post-war formation of the United Nations and its attendant agencies, such as the World Bank, the IMF, the ILO, and various regional commissions, provided an impetus to the shift in focus and perceptions. The commissioning of numerous studies by these institutions led to the emergence of a non-academic strand of development theory.

POST-WAR PERIOD: STAGE THEORY OF GROWTH AND CAPITAL FORMATION

Post-war development was primarily looked at from the viewpoint of growth and capital formation. Even before that, developing nations looked at development primarily as a process of industrialization. This resulted in the concept of a Third World consisting of Latin American, Asian, and African countries, which were to be mostly viewed as “underdeveloped” countries. It was believed that they were in the early stages of development; and with time, they would be able to transcend the various stages. This was contingent upon the way the in which capital was being formed, industrialization was taking place, and GDP growth occurred.

This thought culminated in the “stage” theory of development, made famous by Gerschenkron (1962) and Rostow (1960). The stage theory assumes certain “linearity” in the development patterns of

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