We will examine examples of countries that have tried each alternative, successfully and unsuccessfully.

For most of the twentieth century, self-sufficiency, or balanced growth, was the more popular of the development alternatives. The world’s two most populous countries, China and India, once adopted this strategy, as did most African and Eastern European countries.

**Elements of Self-Sufficiency Approach**

According to the self-sufficiency approach, a country should spread investment as equally as possible across all sectors of its economy and in all regions. The pace of development may be modest, but the system is fair because residents and enterprises throughout the country share the benefits of development. Under self-sufficiency, incomes in the countryside keep pace with those in the city, and reducing poverty takes precedence over encouraging a few people to become wealthy consumers.

The approach nurses fledgling businesses in an LDC by isolating them from competition with large international corporations. Such insulation from the potentially adverse impacts of decisions made by businesses and governments in the MDCs encourages a country’s fragile businesses to achieve independence. Countries promote such self-sufficiency by setting barriers that limit the import of goods from other places. Three widely used barriers include setting high taxes (tariffs) on imported goods to make them more expensive than domestic goods, fixing quotas to limit the quantity of imported goods, and requiring licenses in order to restrict the number of legal importers. The approach also restricts local businesses from exporting to other countries.

For many years India made effective use of many barriers to trade. For example:

- To import goods into India, most foreign companies had to secure a license, a long and cumbersome process because several dozen government agencies had to approve the request.
- Once a company received an import license, the government severely restricted the quantity it could sell in India.
- The government imposed heavy taxes on imported goods, which doubled or even tripled the price to consumers.
- Indian businesses were discouraged from producing goods for export; Indian money could not be converted to other currencies.

Businesses were supposed to produce goods for consumption inside India. Effectively cut off from the world economy, they required government permission to sell a new product, modernize a factory, expand production, set prices, hire or fire workers, and change the job classification of existing workers. If private companies were unable to make a profit selling goods only inside India, the government provided subsidies, such as cheap electricity, or wiped out debts. The government owned not just communications, transportation, and power companies, a common feature around the world, but also businesses such as insurance companies and automakers, left to the private sector in most countries.
protected from international competition were not pressured to keep abreast of rapid technological changes.

2. Need for large bureaucracy. The complex administrative system needed to administer the controls encouraged abuse and corruption. Potential entrepreneurs found that struggling to produce goods or offer services was less rewarding financially than advising others how to get around the complex government regulations. Other potential entrepreneurs earned more money by illegally importing goods and selling them at inflated prices on the black market.

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**Problems with the Self-Sufficiency Alternative**

The experience of India and other LDCs with self-sufficiency revealed two major problems:

1. Protection of inefficient businesses. Businesses could sell all they made, at high government-controlled prices, to customers culled from long waiting lists, so they had little incentive to improve quality, lower production costs, reduce prices, or increase production. Companies protected from international competition were not pressured to keep abreast of rapid technological changes.

2. Need for large bureaucracy. The complex administrative system needed to administer the controls encouraged abuse and corruption. Potential entrepreneurs found that struggling to produce goods or offer services was less rewarding financially than advising others how to get around the complex government regulations. Other potential entrepreneurs earned more money by illegally importing goods and selling them at inflated prices on the black market.
Development Through International Trade

The international trade model of development calls for a country to identify its distinctive or unique economic assets. What animal, vegetable, or mineral resources does the country have in abundance that other countries are willing to buy? What product can the country manufacture and distribute at a higher quality and a lower cost than other countries? According to the international trade approach, a country can develop economically by concentrating scarce resources on expansion of its distinctive local industries. The sale of these products in the world market brings funds into the country that can be used to finance other development.

Rostow’s Development Model

A pioneering advocate of this approach was W. W. Rostow, who in the 1950s proposed a five-stage model of development. Several countries adopted this approach during the 1960s, although most continued to follow the self-sufficiency approach. The five stages were as follows:

1. The traditional society. A traditional society has not yet started a process of development. It contains a very high percentage of people engaged in agriculture and a high percentage of national wealth allocated to what Rostow called “nonproductive” activities, such as the military and religion.

2. The preconditions for takeoff. An elite group initiates innovative economic activities. Under the influence of these well-educated leaders, the country starts to invest in new technology and infrastructure, such as water supplies and transportation systems. These projects will ultimately stimulate an increase in productivity.

3. The takeoff. Rapid growth is generated in a limited number of economic activities, such as textiles or food products. These few takeoff industries achieve technical advances and become productive, whereas other sectors of the economy remain dominated by traditional practices.

4. The drive to maturity. Modern technology, previously confined to a few takeoff industries, diffuses to a wide variety of industries, which then experience rapid growth comparable to the takeoff industries. Workers become more skilled and specialized.

5. The age of mass consumption. The economy shifts from production of heavy industry, such as steel and energy, to consumer goods, such as motor vehicles and refrigerators.

According to the international trade model, each country is in one of these five stages of development. MDCs are in stage 4 or 5, whereas LDCs are in one of the three earlier stages. The model assumes that LDCs will achieve development by moving along from an earlier to a later stage. The model also asserts that today’s MDCs passed through the early stages in the past. The United States, for example, was in stage 1 prior to independence, stage 2 during the first half of the nineteenth century, stage 3 during the middle of the nineteenth century, and stage 4 during the late nineteenth century, before entering stage 5 during the early twentieth century.

A country that concentrates on international trade benefits from exposure to consumers in other countries. To remain competitive, the takeoff industries must constantly evaluate changes in international consumer preferences, marketing strategies, production engineering, and design technologies. This concern for international competitiveness in the exporting takeoff industries will filter through less advanced economic sectors.

Rostow’s optimistic development model was based on two factors. First, in the second half of the twentieth century MDCs in Europe and North America were being joined by others in Southern and Eastern Europe and Japan. If they could become more developed by following this model, why couldn’t other countries? Second, many LDCs contained an abundant supply of raw materials sought by manufacturers and producers in MDCs. In the past, European colonial powers extracted many of these resources without paying compensation to the colonies. In a global economy, the sale of these raw materials could generate funds for LDCs with which they could promote development.

Examples of the International Trade Approach

When most LDCs were following the self-sufficiency approach, two groups of countries chose the international trade approach during the mid-twentieth century.

THE FOUR ASIAN DRAGONS. Among the first countries to adopt the international trade alternative were South Korea, Singapore, Taiwan, and the then-British colony of Hong Kong. These four areas were given several nicknames, including the “four dragons,” the “four little tigers,” and “the gang of four.”

Singapore and Hong Kong, British colonies until 1965 and 1997, respectively, have virtually no natural resources. Both comprise large cities surrounded by very small amounts of rural land. South Korea and Taiwan have traditionally taken their lead from Japan, which occupied both countries until after World War II. Their adoption of the international trade approach was strongly influenced by Japan’s success. Lacking many natural resources, the four dragons promoted development by concentrating on producing a handful of manufactured goods, especially clothing and electronics. Low labor costs enabled these countries to sell products inexpensively in MDCs.

PETROLEUM-RICH ARABIAN PENINSULA STATES. The Arabian Peninsula includes Saudi Arabia, the region’s largest and most populous country, plus Kuwait, Bahrain, Oman, and
the United Arab Emirates. Once among the world's least developed countries, they were transformed overnight into some of the wealthiest thanks to escalating petroleum prices during the 1970s.

Arabian Peninsula countries have used petroleum revenues to finance large-scale projects, such as housing, highways, airports, universities, and telecommunications networks. Their steel, aluminum, and petrochemical factories compete on world markets with the help of government subsidies. The landscape has been further changed by the diffusion of consumer goods. Large motor vehicles, color TVs, audio equipment, and motorcycles are readily available and affordable. Supermarkets are stocked with food imported from Europe and North America.

**Problems with the International Trade Alternative**

Three problems have hindered countries outside the four Asian dragons and the Arabian Peninsula from developing through the international trade approach:

1. **Uneven resource distribution.** Arabian Peninsula countries achieved successful development by means of rising petroleum prices. Other countries found that the prices of their commodities did not increase and in some cases actually decreased. LDCs that depended on the sale of one product suffered because the price of their leading commodity did not rise as rapidly as the cost of the products they needed to buy. For example, Zambia has extensive copper reserves, but it has been unable to use this asset to promote development because of declining world prices for copper.

2. **Increased dependence on MDCs.** Building up a handful of takeoff industries that sell to people in MDCs may force LDCs to cut back on production of food, clothing, and other necessities for their own people. Rather than finance new development, funds generated from the sale of products to other countries may have to be used to buy these necessities from MDCs for the employees of the takeoff industries.

3. **Market decline.** Countries that depend on selling low-cost manufactured goods find that the world market for many products has declined sharply in recent years. Even before the recent severe recession, MDCs had limited growth in population and market size.

**International Trade Approach Triumphs**

In the late twentieth century, most countries embraced the international trade approach as the preferred alternative for stimulating development. Trade has increased more rapidly than wealth (as measured by GDP), a measure of the growing importance of the international trade approach, especially in LDCs (Figure 9-27).

Longtime advocates of the self-sufficiency approach converted to international trade during the 1990s. India, for example, dismantled its formidable collection of barriers to international trade:

- Foreign companies were allowed to set up factories and sell in India.
- Tariffs and restrictions on the import and export of goods were reduced or eliminated.
- Monopolies in communications, insurance, and other industries were eliminated.
- With increased competition, Indian companies have improved the quality of their products.

During the self-sufficiency era, India's auto industry was dominated by Maruti-Udyog Ltd., which was controlled by the Indian government. Nursed by import duties that rose from 15 percent in 1984 to 66 percent in 1991, Maruti captured more than 80 percent of the Indian market selling cars that would be considered out-of-date in other countries. In the international trade era, the government sold control of Maruti to the Japanese company Suzuki, which now holds only 40 percent of India's market.

Countries like India converted from self-sufficiency to international trade during the 1990s for one simple reason—overwhelming evidence that international trade better promoted development (Figure 9-28). The World Bank found that between 1990 and 2005 per capita GDP increased more than 4 percent annually in countries strongly oriented toward international trade, compared with less than 1 percent for countries strongly oriented toward self-sufficiency.
World Trade Organization

To promote the international trade development model, countries representing 97 percent of world trade established the World Trade Organization (WTO) in 1995. The WTO works to reduce barriers to international trade in two principal ways. First, through the WTO, countries negotiate reduction or elimination of international trade restrictions on manufactured goods, such as government subsidies for exports, quotas for imports, and tariffs on both imports and exports. Also reduced or eliminated are restrictions on the international movement of money by banks, corporations, and wealthy individuals.

The WTO also promotes international trade by enforcing agreements. One country can bring to the WTO an accusation that another country has violated a WTO agreement. The WTO is authorized to rule on the validity of the charge and order remedies. The WTO also protects intellectual property in the age of the Internet. An individual or corporation can also bring charges to the WTO that someone in another country has violated their copyright or patent, and the WTO can order illegal actions to stop.

The WTO has been sharply attacked by critics. Protesters routinely gather in the streets outside high-level meetings of the WTO (Figure 9-29). Progressive critics charge that the WTO is antidemocratic, because decisions made behind closed doors promote the interests of large corporations rather than the poor. Conservatives charge that the WTO compromises the power and sovereignty of individual countries because it can order changes in taxes and laws that it considers unfair trading practices.

Foreign Direct Investment

International trade requires corporations based in a particular country to invest in other countries. Investment made by a foreign company in the economy of another country is known as foreign direct investment (FDI).

Foreign direct investment grew rapidly during the 1990s, from $130 billion in 1990 to $1.5 trillion in 2000. The level declined to $647 billion in 2003 in the wake of the 9/11 al-Qaeda attacks on the United States, before returning to $1.5 trillion later in the decade. Foreign direct investment does not
flow equally around the world (Figure 9-30). Only one-fourth of foreign investment in 2007 went from an MDC to a LDC, whereas the other three-fourths went from one MDC to another MDC. And FDI is not evenly distributed among LDCs. More than one-third of all FDI destined for LDCs went to China in 2007, one-third to all other Asian countries, one-fifth to all Latin American countries, and one-tenth to all African countries.

The major sources of FDI are transnational corporations (TNCs). A transnational corporation invests and operates in countries other than the one in which its headquarters are located. Of the 500 largest TNCs in 2008, 140 had headquarters in the United States and 163 in Europe.

**Financing Development**

LDCs lack money to fund development, so they obtain financial support from MDCs. Finance comes from two primary sources—loans from banks and international organizations and direct investment by transnational corporations.

**Loans**

The two major lenders to LDCs are the World Bank and the International Monetary Fund (IMF):

- **The World Bank:** Includes the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD provides loans to countries to reform public administration and legal institutions, develop and strengthen financial institutions, and implement transportation and social service projects. The IDA provides support to poor countries considered too risky to qualify for IBRD loans. The IBRD has loaned about $400 billion since 1945, primarily in Europe and Latin America, and the IDA about $150 billion since 1960, primarily in Asia and Africa. The IBRD lends money raised from sales of bonds to private investors; the IDA from government contributions.

- **The IMF:** Provides loans to countries experiencing balance-of-payments problems that threaten expansion of international trade. IMF assistance is designed to help a country rebuild international reserves, stabilize currency exchange rates, and pay for imports without having to impose harsh trade restrictions or capital controls that could hamper the growth of world trade. Unlike the development banks, the IMF does not lend for specific projects. Funding of the IMF is based on each member country’s relative size in the world economy.

The World Bank and IMF were conceived at a 1944 United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, to promote economic development and stability after the devastation of World War II and to avoid a repetition of the disastrous economic policies contributing to the Great Depression of the 1930s. The IMF and World Bank became specialized agencies of the United Nations when it was established in 1945.

LDCs borrow money to build new infrastructure, such as hydroelectric dams, electric transmission lines, flood-protection systems, water supplies, roads, and hotels. The theory is that new infrastructure will make conditions more favorable for domestic and foreign businesses to open or expand. After all, no business wants to be located in a place that lacks paved roads, running water, and electricity.

In principle, new or expanded businesses are attracted to an area because improved infrastructure will contribute additional...
taxes that the LDC will use in part to repay the loans and in part to improve its citizens’ living conditions. In reality, the World Bank itself has judged half of the projects it has funded in Africa to be failures. Common reasons include:

- Projects don’t function as intended because of faulty engineering.
- Aid is squandered, stolen, or spent on armaments by recipient nations.
- New infrastructure does not attract other investment.

Many LDCs have been unable to repay the interest on their loans, let alone the principal (Figure 9-31). Debt actually exceeds annual income in a dozen countries. When these countries cannot repay their debts, financial institutions in MDCs refuse to make further loans, so construction of needed infrastructure stops. The inability of many LDCs to repay loans also damages the financial stability of banks in the MDCs.

**Structural Adjustment Programs**

The IMF, World Bank, and MDCs fear that granting, canceling, or refinancing debts without strings attached will perpetuate bad habits in LDCs. Therefore, before granting debt relief, an LDC is required to prepare a Policy Framework Paper (PFP) outlining a **structural adjustment program**, which includes economic goals, strategies for achieving the objectives, and external financing requirements.

A structural adjustment program includes economic “reforms” or “adjustments.” Requirements placed on an LDC typically include:

- Spend only what it can afford
- Direct benefits to the poor, not just the elite
- Divert investment from military to health and education spending
- Invest scarce resources where they would have the most impact
- Encourage a more productive private sector
- Reform the government, including a more efficient civil service, more accountable fiscal management, more predictable rules and regulations, and more dissemination of information to the public

Critics charge that poverty worsens under structural adjustment programs. By placing priority on reducing government spending and inflation, structural adjustment programs may result in:

- Cuts in health, education, and social services that benefit the poor
• Higher unemployment
• Loss of jobs in state enterprises and the civil service
• Less support for those most in need, such as poor pregnant women, nursing mothers, young children, and elderly people

In short, structural reforms allegedly punish Earth’s poorest people for actions they did not commit—waste, corruption, misappropriation, and military buildups.

International organizations respond that the poor suffer more when a country does not undertake reforms. Economic growth is what benefits the poor the most in the long run. Nevertheless, in response to criticisms, the IMF and the World Bank now encourage innovative programs to reduce poverty and corruption and consult more with average citizens. A safety net must be included to ease short-term pain experienced by poor people.

**Fair Trade**

Fair trade has been proposed as a variation of the international trade model of development. **Fair trade** means that products are made and traded according to standards that protect workers and small businesses in LDCs. Standards for fair trade are set internationally by Fairtrade Labelling Organisations International (FLO). A nonprofit organization, TransFair USA, certifies the products sold in the United States that are fair trade.

In North America, fair trade products have been primarily craft products such as decorative home accessories, jewelry, textiles, and ceramics. Ten Thousand Villages is the largest fair trade organization in North America, specializing in handicrafts. In Europe, most fair trade sales are in food, including coffee, tea, banana, chocolate, cocoa, juice, sugar, and honey products.

Two sets of standards distinguish fair trade: one set applies to workers on farms and in factories and the other to producers.

**Fair Trade Producer Standards**

Fair trade advocates work with small businesses, especially worker-owned and democratically run cooperatives. Small-scale farmers and artisans in LDCs are unable to borrow from banks the money they need to invest in their businesses. By banding together, they can get credit, reduce their raw material costs, and maintain higher and fairer prices for their products. Cooperatives thus benefit the local farmers and artisans who are members, rather than absentee corporate owners interested only in maximizing profits. Because cooperatives are managed democratically, farmers and artisans learn leadership and organizational skills. The people who grow or made the products thereby have a say in how local resources are utilized and sold. Safe and healthy working conditions can be protected.

Consumers pay higher prices for fair trade coffee than for grocery store brands, but prices are comparable to those charged for gourmet brands. However, fair trade coffee producers receive a significantly higher price per pound than traditional coffee producers. North American consumers pay $4 to $11 a pound for coffee bought from growers for about 80 cents a pound. Growers who sell to fair trade organizations earn $1.12 to $1.26 a pound. Because fair trade organizations bypass exploitative middlemen and work directly with producers, they are able to cut costs and return a greater percentage of the retail price to the producers. In some cases, the quality is higher because fair traders factor in the environmental cost of production. For instance, in the case of coffee, fairly traded coffee is usually organic and shade grown, which results in a higher-quality coffee.

**Fair Trade Worker Standards**

Critics of international trade charge that only a tiny percentage of the price a consumer pays for a good reaches the individual in the LDC responsible for making or growing it. A Haitian sewing clothing for the U.S. market, for example, earns less than 1 percent of the retail price, according to the National Labor Committee. In contrast, fair trade returns on average one-third of the price to the producer in the LDC. The rest goes to the wholesaler who imports the item and for the retailer’s rent, wages, and other expenses.

Protection of workers’ rights is not a high priority in the international trade development approach, according to its critics. With minimal oversight by governments and international lending agencies, workers in LDCs allegedly work long hours in poor conditions for low pay. The workforce may include children or forced labor. Health problems may result from poor sanitation and injuries from inadequate safety precautions. Injured, ill, or laid-off workers are not compensated.

In contrast, fair trade requires employers to pay workers fair wages, permit union organizing, and comply with minimum environmental and safety standards. Under fair trade, workers are paid at least the country’s minimum wage. Sixty to seventy percent of the artisans providing fair trade hand-crafted products are women. Often these women are mothers and the sole wage earners in the home. Because the minimum wage is often not enough for basic survival, whenever feasible, workers are paid enough to cover food, shelter, education, health care, and other basic needs. Cooperatives are encouraged to reinvest profits back into the community, such as by providing health clinics, child care, and training.

Paying fair wages does not necessarily mean that products cost the consumer more. Because fair trade organizations bypass exploitative middlemen and work directly with producers, they are able to cut costs and return a greater percentage of the retail price to the producers. The cost remains the same as traditionally traded goods, but the distribution of the cost of the product is different, because the large percentage taken by middlemen is removed from the equation.