Quadrant II – Transcript and Related Materials

Programme: Bachelor of Arts (Third year)

Subject: Economics

Paper Code: ECD 111

Paper Title: Growth and Development Paper I

Unit: 4

Module Name: The Process of Cumulative Causation

Notes

The hypothesis of cumulative causation as an explanation of the backwardness of developing nations is associated with the name of Gunnar Myrdal (Myrdal (1957)). Basically, it is a hypothesis of geographic dualism, applicable to nations and regions within nations, which can be advanced to account for the persistence of spatial differences in a wide variety of development indices including per capita income, rates of growth of industrialisation and trade, employment growth rates and levels of unemployment. As such, the process of cumulative causation is a direct challenge to static equilibrium theory, which predicts that the working of economic forces will cause spatial differences to narrow. Myrdal contends that in the context of development both economic and social forces produce tendencies towards disequilibrium, and that the assumption in economic theory that disequilibrium situations tend towards equilibrium is false. If this were not so, how could the tendency for international differences in living standards to widen be explained? Thus Myrdal replaces the assumption of stable equilibrium with what he calls the hypothesis of circular and cumulative causation, arguing that the use of this hypothesis can go a long way towards explaining why international differences in levels of development, and interregional differences in development within nations, may persist and even widen over time.

He first considers the hypothesis in the context of a geographically dual economy, describing how, through the media of labour migration, capital movements and trade, the existence of dualism not only retards the development of the backward regions but can also slow up the development of the whole economy. To describe the process of circular and cumulative causation, let us start off with a country in which all regions have attained the same stage of development as measured by the same level of per capita income, or by similar levels of productivity and wages in the same occupations. Then assume that an exogenous shock produces a disequilibrium situation with development proceeding more rapidly in one region than another. The proposition is that economic and social forces will tend to strengthen the disequilibrium situation by leading to cumulative expansion in the favoured region at the expense of other regions, which then become comparatively worse off, retarding their future development. These contrasts with neoclassical equilibrium theory which assumes that, through the process of factor mobility, wage rates and the rate of profit will equalise across regions. According to neoclassical theory, where labour is scarce and capital is abundant, labour will flow in and capital will flow out thus reducing wages and raising the rate of profit, while in less prosperous areas where labour is abundant, labour will flow out and capital will flow in, raising wages and reducing the rate of profit. By contrast, what Myrdal has in mind is a type of multiplier-accelerator mechanism producing increasing returns in the favoured region. Instead of leading to equality, the forces of supply and demand interact with each other to produce cumulative movements away from spatial equilibrium.

Capital movements and trade also play a part in the process of cumulative causation. In a free market, capital, like labour, will tend to move to where the prospective return is highest and this will be to the region where demand is buoyant. Capital, labour and entrepreneurship will tend to migrate together. The benefits of trade will also accrue to the host region. Regions within a nation using a common currency cannot have balance of-payments difficulties in the normal sense, but the maintenance of employment depends on the ability to export, otherwise unemployment will appear. If production is subject to increasing returns, the region experiencing the rapid growth of factor supplies will be able to increase its competitive advantage over the relatively lagging regions containing smaller-scale industries, and increase its real income accordingly. In the same way, the general freeing and widening of international markets and the expansion of world trade will tend to favour the more rapidly growing regions within nation-states. The impact of immigration into the expanding region is also likely to induce improvements in transport and communications, education and health facilities, etc., improving efficiency and productivity and widening still further the competitive advantage of the growing region over the lagging regions experiencing out-migration of the factors of production.

Despite these potential advantages of nationhood for a backward region, however, Hirschman argues against sovereignty because he believes that the forces making for the interregional transmission of growth are likely to be more powerful than those making for 'international' transmission. This presupposes, however, that the forces making for the interregional transmission of growth are lost, and begs the question of whether the differential advantages of being a region within a nation, as distinct from a separate 'nation', offset the 'backwash' effects that still remain. Hirschman recognises the continued existence of 'backwash' effects and argues that, to offset them, a nation which is concerned with developing its backward regions should provide certain equivalents of sovereignty, such as a separate tax system and the right to protect certain activities. Policies must be designed to reduce what he calls the 'polarisation' effects of interregional differences in development and to strengthen the 'trickling down' effects. The 'trickling down' effects are the favourable repercussions on backward regions emanating from expanding regions, which Myrdal calls 'spread' effects. These 'trickling down' or 'spread' effects consist mainly of an increased demand for the backward areas' products and the diffusion of technology and knowledge. In Myrdal's view, the 'spread' effects are weaker than the 'backwash' effects, and if interregional differences are to be narrowed, nations must rely on state intervention. The alternative is to wait for a natural end to the process of cumulative causation, which may be a long time coming But a time must eventually come when increasing costs in the expanding region will halt expansion. The higher costs of living, and the external diseconomies produced by congestion, will ultimately outweigh the benefits of greater efficiency and higher money returns to the factors of production. The process of migration will then be halted, and possibly reversed. In some developed countries this stage is now beginning to be reached. The question for governments with certain growth and welfare objectives is whether they can afford to let the process take its natural course, and to tolerate the inequalities that may arise before the process ends. In practice, governments in many advanced countries have taken active steps for many years to redress regional imbalances, and this is one reason why regional disparities tend to be less in advanced countries than in developing countries. In the developing countries, however, Myrdal is of the view that, far from lessening regional inequalities, the state has been a positive force making for their persistence: 'In many of the poorer countries the natural drift towards inequalities has been supported and magnified by built-in feudal and other inegalitarian institutions and power structures which aid the rich in exploiting the poor' (Myrdal (1963 edn), p. 40)