

Criticisms of The Neo-Classical Development Model

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At the end of World War II the ideologies of the United States and the Soviet Union were at odds. The two super powers could not reach an agreement on how to reconstruct the economies destroyed by the war. The development strategies produced in the United States sought to contain communism while spreading capitalism throughout the world. The conflict that ensued came to be known as the Cold War and development strategy was only one of many arenas in which this clash played out. Years after the Cold War prevailing development models still compete against the communist theory. One such model is the Neo-Classical development model. Rooted in early economic thought, Neo-Classical development aims to spur economic growth through government support. A series of market failures in the 1960's led to the idea that the government should provide infrastructure to support the market. Based on the theory of Neo-Classical economics, this model aims to construct organized markets to increase productivity and development. It hinges on the idea that investment will increase the growth rate of per capita output. The theory captures the importance of efficient markets and investment in economic development, but completely ignores more important factors. Neo-Classical development fails to provide a long term solution to developing countries and ultimately leads to unsustainable development.

Before criticizing a specific model or even evaluating its' success it is important to understand the different historical methods of economic development. Very different paths to economic development have been taken since the Industrial Revolution. The first participants in the Industrial revolution experienced very productive agricultural sectors which created surpluses. These surpluses allowed for specialization in other industries.

These countries were the first to develop structured markets and took an export-led industrialization path. Late participants in the Industrial Revolution suffered from a less productive agricultural sector, had less advanced markets and institutions, and had to rely on inward growth due to lack of trade. Many land scarce countries throughout history have suffered from low productivity growth and experienced massive poverty. Others have benefited from balanced productivity growth in agriculture and industry, allowing them to build developed markets and rely on a diverse export led economy. Economists have learned from history. The most successful countries benefited from more developed markets, high factor endowments, human resources, and political systems receptive to capitalism.

The Neo-Classical development model is centered around Neo-Classical economic theory. Neo-Classical economics focuses on prices, outputs, and income distributions in markets determined through supply and demand. The primary goal of Neo-Classical Economics is to provide efficient allocation of scarce resources. It assumes an individual's rationality enables them to maximize their utility or profit. An emphasis is placed on equilibrium. The interactions of consumers and firms in a free market should yield an equilibrium quantity and supply. The architects of the Neo-Classical

Development model knew that highly developed markets and institutions were needed for the theory to work. It calls for the government to accumulate capital by removing trade barriers and encouraging foreign direct investment. Once capital is accumulated it should flow from areas of low productivity to areas of higher productivity. As per capita productivity grows economic growth will ensue. This is only a brief synopsis of the model, but it illustrates the basic assumptions made.


The key criticisms of the Neo-Classical development model should be in the scope of its' assumptions. There are a wide range of problems faced by developing countries and this model addresses very few of them. It succeeds in creating an economy receptive to capitalism, but fails to benefit the population as a whole. There is historical evidence showing developed markets and advanced institutions are crucial to economic development. How about the accumulation of human capital or the affects of corruption? The Neo-Classical Development model fails to address these issues. Barriers to economic development are not always measurable. Productivity increases and capital accumulation do not directly benefit an impoverished population. Neo-Classical economics is based on Utilitarianism. So it is important to ask does the application of this model result in "the greatest good for the greatest number"?¹ The greatest benefit seems to be to more established capitalist economies. The greatest failure seems to be it's reliance on weak sustainability, which I aim to focus on.


Take a hypothetical example. Say a developing country decides to prescribe fully to the Neo-Classical Development model. Like most developing countries this one has large amounts of unskilled labor and abundant natural resources, but lacks the necessary


• ¹ Morey, Edward. Lecture Notes: "Notes on Moral Philosophies"

capital to extract these resources. As these emerging economies develop they will begin to export goods in which they have a comparative advantage. This comparative advantage will most likely exist in the form of labor intensive goods and natural resources. Their economy will rely heavily on the export of these goods. Multi-National Corporations can set up factories to take advantage of cheaper labor and increased access to natural resources. Foreign Direct Investment will flow into industries such as mining, fishing, and forestry. This economy will begin to export raw materials and with open markets begin to enjoy more choices in finished goods imported from foreign countries. Per capita GDP will increase as consumption and labor productivity increase. Per capita GDP is a key determinant of the Human Development Index which measures living conditions in developing countries. It is also a measurement of success according to Neo-Classical theorists. As the country continues to use this theory the economy will continue to show signs of progress. It will appear the country is developing. Unfortunately such measures are not fully representative of the state of these economies. The Neo-Classical Development model is based on the premise of weak sustainability. Weak sustainability is a fairly simple premise which states overall capital stock should be non-decreasing. It allows for natural resources to be completely depleted as long as other forms of capital compensate for this loss. A country could quickly find itself on a track to unsustainable development.



It is important to differentiate the many different types of capital, specifically natural capital. Furthermore, it is important to differentiate the different types of natural capital, it can be both renewable and non renewable. For example a section of forest can be cut down for lumber and replanted. However the natural resources extracted from mining are considered somewhat finite. Making these distinctions forces you to think of the important role the environment plays in development. The Neo-Classical model  undervalues the role of the environment. A paper by Robert Costanza and Herman Daly attempts to put it into perspective.

“We believe that, if we are to achieve sustainability the economy must be viewed in its’ proper perspective as a subsystem of the larger ecological system of which it is a part, and that environmental and ecological economies need to become much more pervasive approaches to the problem. Natural capital produces a significant portion of the real goods and services of the ecological economic system. So failure to adequately account  for it leads to major misperceptions about how well the economy is doing.”²

A countries reliance on the Neo-Classical Development model will lead to misleading  signs of growth. While certain statistics will indicate a higher output and increased living standards they will fail to capture the sustainability of this growth.

• ² Costanza, Robert. Daly, Herman. “Natural Capital and Sustainable Development”. Conservation Biology Vol. 6, No. 1 (Mar. 1992) pp 37-46

“Growth is destructive of natural capital and beyond some point will cost us more than it is worth—that is, sacrificed natural capital will be worth more than the extra man made capital whose productions necessitated the sacrifice. At this point growth has become anti-economic, impoverishing rather than enriching.”³

The Neo-Classical Development model points us in the right direction. It recognizes the importance of advanced markets and institutions to economic growth. History has demonstrated their importance. It also recognizes the importance of free trade to economic growth. It fails to recognize the importance of natural resources and sustainable development. This is a significant shortcoming. As long as the model is guided by the principle of weak sustainability it will continue to be a poor director of economic growth in developing countries.



- ³ Costanza, Robert. Daly, Herman. “Natural Capital and Sustainable Development”. Conservation Biology Vol. 6, No. 1 (Mar. 1992) pp 37-46

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