G. Myrdal, Economic Theory and Underdeveloped Regions, (1957)

CHAPTER 3

THE DRIFT TOWARDS REGIONAL ECONOMIC INEQUALITIES IN A COUNTRY

A Simple Illustration

I have suggested that the principle of interlocking, circular inter-dependence within a process of cumulative causation has validity over the entire field of social relations. It should be the main hypothesis when studying economic under-development and development.

Suppose that in a community an accidental change occurs which is not immediately cancelled out in the stream of events: for example, that a factory, where a large part of the population gets its livelihood, burns down and that it becomes clear that it would not pay to rebuild it, at least not in that locality. The immediate effect of this primary change is that the firm owning it goes out of business and its workers become unemployed. This will decrease incomes and demand.

In its turn the decreased demand will lower incomes and cause unemployment in all sorts of other businesses in the community which sold to, or served, the firm and its employees. A process of circular causation has so been started with effects which cumulate in the fashion of the "vicious circle".

If there are no other exogenous changes, the community will be less tempting for outside businesses and workers who had contemplated moving in. As the process gathers momentum, businesses established in the community and workers living there will increasingly find reasons for moving out in order to seek better markets somewhere else. If they do, this will again decrease incomes and demand. It will usually also change the age structure of the local population in an unfavourable direction.

To throw light on the mechanism of this cumulative causal sequence, let us watch the behaviour of one single factor and let us choose one a little outside: the local tax rate. I shall assume that local taxation is either, as in Scandinavia, levied directly on incomes or, as in many other parts of the world, indirectly related to them. As the income basis narrows, the tax rate will have to be raised.

The higher tax rate, in its turn, will itself act as an extra incentive for businesses and workers to leave the community, and as a disincentive keeping out those who otherwise might have considered moving in. This then, in a second round, will again decrease incomes and demand and, consequently, cause the tax rate to move still further upwards, having much similar effects again. Meanwhile the less favourable age distribution will have not only contributed to lower taxable income per head, but also raised the relative need for public welfare services.

If in this situation the local authorities, because of the rising tax rate, are moved to lower their standards in various public services—such as the provision of schooling for children, homes for the aged, roads, and the like—the rise of the tax rate may be retarded but only at the expense of making the community less attractive for businesses and workers in another important respect.

Should the tax rate before the first change have reached a stationary level, it is now not moving towards this level as an equilibrium—or any other stable level—but continuously away from the initial state of balancing forces. And this movement itself is all the time causing new changes which push the tax rate still higher, and so on and so on. This simple model of circular causation with cumulative effects, released by a primary change, is, I believe, more typical of actual social processes than the intersection of the demand and supply curves at an equilibrium price which has become symbolic of much of our reasoning in economic theory.

If, nevertheless, in well-organised welfare states the local tax rate does not continue on that adventurous course but is prevented from rising too much, and if also the community is restrained from lowering the standards of public services too much, this has quite another explanation than the play of market forces: namely the fact that national legislation has been enacted for the specific

purpose of stopping such a cumulative process by subsidising from the common purse any individual community which for reasons outside its own command has got into financial difficulties, and at the same time prescribing certain minimum standards for public services.

Indeed, the modern highly integrated national states in the one-sixth of the non-Soviet world which is well off and rapidly progressing have furnished themselves with a most complex network of systems of regularised public interferences of all sorts which have the common purpose of counteracting the blind law of cumulative social change, and hindering it from causing inequalities between regions, industries and social groups. To this question of the countervailing changes induced by organised society I shall come back in the next chapter.

In my example the primary change was an adverse one. The cumulative process, however, also works if the initial change is for the better. The decision to locate an industry in a particular community, for instance, gives a spur to its general development. Opportunities of employment and higher incomes are provided for those unemployed before or employed in a less remunerative way. Local businesses can flourish as the demand for their products and services increases. Labour, capital and enterprise are attracted from outside to exploit the expanding opportunities. The establishment of a new business or the enlargement of an old one widens the market for others, as does generally the increase of incomes and demand. Rising profits increase savings, but at the same time investments go up still more, which again pushes up the demand and the level of profits. And the expansion process creates external economies favourable for sustaining its continuation.

The local tax rate—the factor I picked out for a closer view on the causal inter-relations in a downward cumulative process—can be lowered, and the amount and quality of public services enhanced: both changes will make the community more attractive to businesses and workers for this reason also, with the result that the local finances will again be boosted, with similar results on the tax rate and public finances, and so on.

These fiscal effects of localised expansion may be reduced as a result of interferences by the state in the form of schemes for inter-regional equalisation built into the taxation system; but as in the present chapter I am still considering only the free play of the market forces I shall neglect this possibility for the moment.

The Play of the Market Forces Works towards Inequality

A cumulative process of the same general character, going downwards or upwards as the case may be, will also be generated by a change in the terms of trade of a community or a region, if the change is large and persistent enough or, indeed, by any other change having as its effect a substantial decrease or increase in the inter-related economic quantities: demand, earning power and incomes, investment and production. The main idea I want to convey is that the play of the forces in the market normally tends to increase, rather than to decrease, the inequalities between regions.

If things were left to market forces unhampered by any policy interferences, industrial production, commerce, banking, insurance, shipping and, indeed, almost all those economic activities which in a developing economy tend to give a bigger than average return—and, in addition, science, art, literature, education and higher culture generally—would cluster in certain localities and regions, leaving the rest of the country more or less in a backwater.

Occasionally these favoured localities and regions offer particularly good natural conditions for the economic activities concentrated there; in rather more cases they did so at the time when they started to gain a competitive advantage. For naturally economic geography sets the stage. Commercial centres are, of course, usually located in places where there are reasonably good natural conditions for the construction of a port, and centres for heavy industry are most often located not too far away from coal and iron resources.

But within broad limits the power of attraction today of a centre has its origin mainly in the historical accident that something was once started there, and not in a number of other places where it

could equally well or better have been started, and that the start met with success. Thereafter the ever-increasing internal and external economies—interpreted in the widest sense of the word to include, for instance, a working population trained in various crafts, easy communications, the feeling of growth and elbow room and the spirit of new enterprise—fortified and sustained their continuous growth at the expense of other localities and regions where instead relative stagnation or regression became the pattern.

Migration, Capital Movement and Trade: the "Backwash Effects"

It is easy to see how expansion in one locality has "backwash effects" in other localities. More specifically the movements of labour, capital, goods and services do not by themselves counteract the natural tendency to regional inequality. By themselves, migration, capital movements and trade are rather the media through which the cumulative process evolves—upwards in the lucky regions and downwards in the unlucky ones. In general, if they have positive results for the former, their effects on the latter are negative.[1]

The localities and regions where economic activity is expanding will attract net immigration from other parts of the country. As migration is always selective, at least with respect to the migrant's age, this movement by itself tends to favour the rapidly growing communities and disfavour the others.

In the historical epoch—which is only just now coming to its end in the very richest and most advanced countries—when birth-control is still spreading to lower economic and social strata,[2] the poorer regions will also have a relatively higher fertility. This adds its influence to that of the net emigration in making the age distribution in these regions unfavourable; in the longer run it may also cause a less favourable relation between total working population and resources. The poverty in rural regions of Europe during the

[1] This statement will be qualified in the next section but one.

[2] When this process is completed, the average fertility might well be rather high or at times even rising; but it is positively, and not negatively, correlated to economic and social status.

long period of net emigration to the industrial centres—and to America—has a main explanation in the unfavourable age distribution there, caused by migration and in part also by higher fertility rates.

Capital movements tend to have a similar effect of increasing inequality. In the centres of expansion increased demand will spur investment, which in its turn will increase incomes and demand and cause a second round of investment, and so on. Saving will increase as a result of higher incomes but will tend to lag behind investment in the sense that the supply of capital will steadily meet a brisk demand for it. In the other regions the lack of new expansionary momentum has the implication that the demand for capital for investment remains relatively weak, even compared to the supply of savings which will be low as incomes are low and tending to fall. Studies in many countries have shown how the banking system, if not regulated to act differently, tends to become an instrument for siphoning off the savings from the poorer regions to the richer and more progressive ones where returns on capital are high and secure.

Trade operates with the same fundamental bias in favour of the richer and progressive regions against the other regions. The freeing and widening of the markets will often confer such competitive advantages on the industries in already established centres of expansion, which usually work under conditions of increasing returns, that even the handicrafts and industries existing earlier in the other regions are thwarted. The hampering of industrial growth in the poorer southern provinces of Italy, caused by the pulling down of internal tariff walls after Italy's political unification in the last century, is a case in point which has been thoroughly studied: industry in the northern provinces had such a lead, and was so much stronger that it dominated the new national market, which was the result of political unification, and suppressed industrial efforts in the southern provinces.[1]

[1] The process was conditioned and encouraged by the liquidation of the political and administrative centres in Southern Italy, while those in Northern Italy, which at that time more than now were tools in the hands of the industrial interests there, gained hegemony over the whole country. The unification of

As industrialisation is the dynamic force in this development, it is almost tautological to state that the poorer regions remain mainly agricultural: the perfection of the national markets will even, as I have just mentioned, tend to frustrate earlier beginnings of industrial diversification in agricultural regions. In the backward regions of Southern Europe about three quarters of the population get their livelihood from agriculture. In these regions also, not only manufacturing industry and other non-agricultural pursuits but agriculture itself show a much lower level of productivity than in the richer regions.[1]

The "Non-economic Factors"

The cumulative processes towards regional inequality work through many causal chains usually not accounted for in our theoretical analysis of the play of market forces. I have already referred to selectivity in migration and the effects of poverty on fertility.

If left to themselves, those regions which had not been touched by the expansionary momentum could not afford to keep up a good road system, and all their other public utilities would be inferior, thus increasing their competitive disadvantages. Railways would be built so as to meet the effective demand for transport, i.e. without much consideration of the needs of those regions.

Italy was in reality very much a conquest and an annexation of Southern Italy by the stronger North. The role of the state in the cumulative process will be discussed in the next chapter.

Another example on a still larger scale is the long economic stagnation after the Civil War up till the Second World War of the Southern states of the United States. As I shall argue in Chapter 5, this systematic bias of trade as between regions forms also part of the mechanism of exploitation in the economic relations between a metropolitan country and its colonies.

[1] Part of the stronger competitive position of industry in Northern Italy at the time of Italy's political unification was based on the fact that it also had a more developed agriculture.

Professor Jacob Viner makes the plausible point that "... the real problem in poor countries is not agriculture as such, or the absence of manufactures as such, but poverty and backwardness, poor agriculture and poor manufacture" (*International Trade and Economic Development*, Clarendon Press, Oxford, 1953, p. 52). This is supposed to be a criticism of Professor Raul Prebisch and others who have urged industrialisation as the necessary mainstay in a programme of economic development. As his argument is narrowly static, Viner, however, misses entirely the point that industrialisation is intended to rectify an economy in imbalance and to give a dynamic momentum.

On the same assumption the poorer regions, unaided, could hardly afford much medical care and their populations would be less healthy and have a lower productive efficiency. They would have fewer schools and their schools would be grossly inferior—in Southern Europe the population of the poorer regions is actually still largely illiterate.

The people living there would on the average be believers in the more primitive variants of religion, sanctioning traditional *mores* by taboos and functional magic, and they would be more superstitious and less rational generally. Their entire systems of valuations would take on such an imprint of poverty and backwardness that they would become even less susceptible to the experimental and ambitious aspirations of a developing society.

All these frustrating effects of poverty, operating through other media than those analysed by traditional economic theory, are interlocked in circular causation, the one with the others and all with the biases I referred to in the working of migration, capital movements and trade. The opposite effects of rising economic levels in the centres of expansion are in a similar fashion also interconnected in a circular causation, continuously sustaining further expansion in a cumulative fashion.

Economic theory has disregarded these so-called non-economic factors and kept them outside the analysis. As they are among the main vehicles for the circular causation in the cumulative processes of economic change, this represents one of the principal shortcomings of economic theory. As I pointed out in Chapter 2 and shall further pursue in Chapter 11, it explains largely why this theory was unable to state the dynamic problems of economic under-development and development—or, to formulate it differently, how this theory managed to avoid stating those problems.

For easy reference I shall refer to all relevant adverse changes, caused outside that locality, as the "backwash effects" of economic expansion in a locality. I include under this label the effects *via* migration, capital movements and trade as well as all the effects *via* the whole gamut of other social relations exemplified above; and the term refers to the total cumulated effects resulting from

the process of circular causation between all the factors, "non-economic" as well as "economic".

It should be pointed out in this connection that all history shows that the cheap and often docile labour of under-developed regions does not usually attract industry. The few examples where the labour supply has been effective in bringing industry to backward regions—the movement of textile industry from New England to the Upper South in the United States is one case—are rather in the nature of exceptions to a general rule. There are so many forces working in the opposite direction, among them the external economies in the established centres of economic expansion. Ordinarily it is labour which has to move to the localities of rising demand and there make the difficult effort of adjustment to the different ways and values of an expanding society.

The "Spread Effects"

Against the backwash effects there are, however, also certain centrifugal "spread effects" of expansionary momentum from the centres of economic expansion to other regions. It is natural that the whole region around a nodal centre of expansion should gain from the increasing outlets of agricultural products and be stimulated to technical advance all along the line.

There is also another line of centrifugal spread effects to localities farther away, where favourable conditions exist for producing raw materials for the growing industries in the centres; if a sufficient number of workers become employed in these other localities even consumer goods industries will be given a spur there. These, and also all other localities where new starts are being made and happen to succeed, become in their turn, if the expansionary momentum is strong enough to overcome the backwash effects from the older centres, new centres of self-sustained economic expansion.

The spread effects of momentum from a centre of industrial expansion to other localities and regions, operating through increased demands for their products and in many other ways, weave themselves into the cumulating social process by circular causation in the same fashion as the backwash effects in opposition to which they set up countervailing changes. They represent a complication of the main hypothesis that in the normal case the changes in other factors which are called forth as reactions by a change in one factor, always tend to move the system in the same direction as the first change.

In no circumstances, however, do the spread effects establish the assumptions for an equilibrium analysis. In the marginal case the two kinds of effects will balance each other and a region will be "stagnating". But this balance is not a stable equilibrium, for any change in the forces will start a cumulative movement upwards or downwards.

In reality, the expanding, stagnating and regressing localities are arranged in a fairly continuous series on different levels, with all possible graduations between the extremes. Insofar as in the aggregate all the dispersed industrial advances amount to something considerable, economic standards in the whole country are given a lift.

It is quite possible that all the regions in a country may be inside this margin of balancing forces—if the initial starts are many and strong and successful enough and if the centrifugal spread effects work relatively effectively. The problem of inequalities then becomes a problem of the different rates of progress between regions in the country. But ordinarily, even in a rapidly developing country, many regions will be lagging behind, stagnating or even becoming poorer; and there would be more regions in the last two categories if market forces alone were left to decide the outcome.

Even in such countries as the United States or Sweden, where in the last century business enterprise has been able to exploit a particularly favourable situation as regards natural resources, and where other unusually advantageous conditions for economic growth have also been present, not least in the general cultural situation, developments have not been such as to draw the whole country into a more or less equal and simultaneous expansion process. A closer view reveals great disparities. In the United States, for example, almost the whole of the region usually referred to as the South was until recently largely a stagnating one.

Similarly, the emergence some generations ago of the great new opportunities in agriculture on the Western frontier left large rural areas in New England in a decay from which some of them have not yet emerged.

A country where, on the contrary, few starts are being made and/or where the starts do not happen to result in a substantial and sustained increase in demand, incomes, investment and production, becomes an under-developed country. Even there, however, as in several Latin American countries, there are usually localities and regions which are advancing industrially.

Two Broad Correlations

The Secretariat of the United Nations' Economic Commission for Europe has for several years devoted increasing attention to the empirical study of the problem of regional development and under-development in various European countries. The results so far reached have been published in the annual *Economic Surveys of Europe*. In 1955 a more comprehensive analysis of these problems was contained in a separate chapter of the Survey.[1] From this study I want only to quote two main conclusions.

The first one is that in Western Europe disparities of income between one region and another are much wider in the poorer countries than in the richer ones. If we use such a simple measure of regional inequality as the proportion of the total population of a country living in regions where the average income is less than two-thirds of the national average, we find that this proportion amounted to only a few per cent in Great Britain and Switzerland, to some ten per cent in such countries as Norway and France, and to about one-third in Italy, Turkey and Spain.[2]

The second conclusion is that while the regional inequalities have been diminishing in the richer countries of Western Europe, the tendency has been the opposite in the poorer ones.

[1] "Problems of Regional Development and Industrial Location in Europe", *Economic Survey of Europe in 1954*, Geneva, 1955, pp. 136ff.

[2] Not only the inequalities within each country but also the differences in relative inequality between countries would have appeared much greater, if the administrative division into regions used for the tabulation had been more adequate to the problem studied.

A large part of the explanation for these two broad correlations may be found in the important fact that the higher the level of economic development that a country has already attained, the stronger the spread effects will usually be. For a high average level of development is accompanied by improved transportation and communications, higher levels of education, and a more dynamic communion of ideas and values—all of which tends to strengthen the forces for the centrifugal spread of economic expansion or to remove the obstacles for its operation.

The neutralisation of the backwash effects, when a country reaches a high level of development where the spread effects are strong, will itself spur on economic development, and so become an important factor in the cumulative process. For with the extinction of abject poverty on a large scale goes a fuller utilisation of the potentialities of the human resources in a nation. This is one of the reasons why rapid and sustained progress becomes an almost automatic process when once a country has reached a high level of development.

In contrast, part of the curse of a low average level of development in an under-developed country is the fact that the spread effects there are weak. This means that as a rule the free play of the market forces in a poor country will work more powerfully to create regional inequalities and to widen those which already exist. That a low level of economic development is accompanied as a rule by great economic inequalities represents itself a major impediment to progress. It tends to hold the under-developed countries down. This is one of the interlocking relations by which in the cumulative process "poverty becomes its own cause".

I cannot overcome the temptation to repeat my quotation from the Bible: "For unto every one that hath shall be given, and he shall have abundance: but from him that hath not shall be taken away even that which he hath." That there is a tendency inherent in the free play of market forces to create regional inequalities, and that this tendency becomes the more dominant the poorer a country is, are two of the most important laws of economic under-development and development under *laissez-faire.*

In this chapter I am disregarding interferences by the state. In the next chapter, where I discuss the role of the state, my general point is that the activity of the state will tend rather to support those forces which result in the two broad correlations which I have been discussing.

Examples of Other Counteracting Changes

There are a great number of complications and qualifications that in a more elaborate analysis would have to be fitted into the model I am outlining of circular causation of a cumulative social process. They are all related to exceptions from the hypothesis that the causation is circular.

If there are counteracting changes the cumulative effect will be weakened and the process may even be stopped altogether. But even in the accidental event that the forces come to balance each other, the assumption for an equilibrium analysis will ordinarily not be established, for the balance will be unstable. On both sides of such a fortuitous balance the system will entail a cumulative process in the causation of which, however, not all changes are unidirectional and connected.

Among counteracting changes there are those which may be recognised as "external dis-economies", if the term be allowed. There may be factors inherent in the situation of a centre of economic expansion which tend to retard or, when it has reached a certain level of development, even to reverse the cumulative process, by causing an increase in public expenditure and perhaps in private costs, because industry and population become too concentrated. Once again this can be stated in the homely terms of folk wisdom: "Trees can never grow as high as heaven."

To the same category would belong the depressing effects of decreasing demand in a "maturing economy", if this pessimistic theory, cultivated during the Great Depression, particularly in America, were correct—which, however, I doubt, except in very special circumstances.

It may also be that in a centre of expansion wages and the remuneration of other factors of production will be driven up to such a high level that other regions get a real chance to compete successfully. Or a prolonged period of economic expansion may have saddled a prosperous region with a very large stock of old capital equipment which it is tempting not to discard as rapidly as would be advantageous in a period of swift technological development. Moreover, a country which, thanks to an early start, has for some time enjoyed a quasi-monopolistic position may find that the spirit of enterprise and risk-taking has been damaged.[1]

In the opposite case, a downward cumulative process may also give rise to endogenous countervailing forces and come to a halt. The cruel Malthusian checks of classical population theory—a rise in death rates when population increase had pressed down consumption below the subsistence level—were examples of such countervailing changes. These checks set a limit beyond which regression could not proceed and thus established a lower limit to the process. Assuming a permanency in the forces operating in the direction of economic regression, equilibrium at this low level would indeed for once be a stable one. The recent explosive development of medical science, making the prevention of death even at exceedingly low standards of living a rather easy and inexpensive matter, has tended to weaken the population checks, and thus moved the stagnation equilibrium to a much more depressed level of human misery.

Naturally, in the short run, in all countries and in all regions at all times the equilibrating interplay of countervailing changes in demand, supply and price—to which economic theory has devoted such a disproportionate amount of attention—will be operating more or less according to that theory. This interplay, however, usually represents only the ripples on the surface.

In general, changes of anticipation consequent on more primary changes tend rather to push a cumulative process in the same direction; this agrees with the main hypothesis. Thus, already an

[1] An analysis of these and other factors which may retard an expansionary movement, as they operated in Europe in the period between the two world wars, is contained in Professor Ingvar Svennilson's *Growth and Stagnation in the European Economy*, United Nations' Economic Commission for Europe, Geneva, 1954.

expectation on the part of the white population that the Negro plane of living will rise normally tends to decrease white prejudice. In certain regions of the South in America and, in particular, among the poor whites who compete most closely with the Negroes, such an expectation may, however, at least for a time, instead cause rising resentment and increased prejudice, which then introduces an opposite secondary reaction but, of course, no equilibrium.

When rising prices cause people to expect further price increases, this will normally induce them to buy more and sell less, so that the primary tendency of the prices to rise will be strengthened, and this agrees with our hypothesis of circular causation. Indeed, it was mainly to the part played by anticipations in the cumulative movement of an economy away from price stability that Wicksell attributed the acceleration of the process in its later stages.[1] But, of course, it is possible that people may be so conditioned by theory or earlier experience that they will expect that after a rise in prices there will follow a fall; this then, of course, has the contrary effect.

A realistic study of any social process will have to reckon with a great variety of differently inter-related changes in response to a primary change, and I do not deny that sometimes those changes are inter-linked in such a way as to counteract each other. Nevertheless, I believe that when main trends over somewhat longer periods are under consideration, the changes will in the main support each other and thus tend to be cumulative in their net effects.

A

Changes in General Business Conditions

It has to be remembered, however, that long-term changes are nothing more than the cumulative results of a succession of short-run changes, among which are the short-term fluctuations in the general business conditions of a country. A boom implies a generalised spur to expansion over the whole economic field. It will perhaps usually have its most powerful effects in the established industrial centres, but may induce a number of new starts

[1] Wicksell's policy goal of a constant price level was not to be expected as an outcome of the play of the forces in the market but as a result of intentional monetary policy.

in other localities or encourage lagging activity—the result of earlier starts, which were losing momentum—to continue. A boom will probably always increase the relative strength of the spread effects. A depression will decrease it.

Changes in general business conditions are traditionally dealt with as "the business cycle problem" and this tradition has continued long after these changes seem to have lost every appearance of being cyclical. This is, of course, due to our recognition that there are in the system self-generating changes of the countervailing type, though not contained in the same time-space, and this is also my reason for referring to the problem in the present section. Business cycle research has been dominated by the time series: interest has been focused on the aggregate changes from one point or period of time to another, while disregarding the differences in geographic space and even the changes in time of these spatial differences.

I believe that more intensive research on the changes in general business conditions, focused more specifically on their consequences for economic development, would be rewarding. This would imply research on the differences between localities and regions, as those differences change under the influence of the play of forces in the market during changes in general business conditions.