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What Do We Know about Economic Development?

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This article is an idiosyncratic review of several recent books on development, some older ones, and a critique of development economics as applied to promoting development. It discusses various analyses of factors causing economic development or preventing it, suggesting that general theories only go so far and specific knowledge is needed. Some of this knowledge concerns the thinking of elites, their choices of whether or not to stay in their country and under what terms, and how various interest groups relate.

Keywords: *development; interest group; institutions*

Economic development as a separate field of economics emerged in the 1940s and 1950s and has been an awkward stepchild in the economics profession in spite of its obvious importance. Initially populated mainly by those who saw market failures everywhere and had undue sympathy for economic planning of a nearly socialist variety, it has been subject to fads that have proven inadequate to the challenge of providing productive advice. William Easterly (2002), in his critical study, *The Elusive Quest for Growth*, takes the reader on a guided tour of the discredited development fads, from injecting physical capital to developing human capital to population control to lending for (promised) reform to debt forgiveness. But Easterly's useful deconstruction of single "silver bullets" does not allow for interactions of the various plausible variables. In any case, things such as having infrastructure or educated people, while hardly sufficient, are likely to be helpful for growth and might make other necessary steps more attractive if they are present.

This review will summarize some of what is known about economic growth as captured in a few recent books and reports. First, a warning: this is not a review of economic aid. Aid is seldom crucial to sustained economic growth unless it is used to get out of conflict or disaster situations. It may be helpful or not, depending on how it is given and received. But sustained growth and associated broad welfare gains involve the decisions that elites within a country make. Aid is seldom used strategically to influence the discussions that lead up to those decisions, and so works well when the direction is already right and poorly when elites have other interests than promoting growth. It is also not involved with "growth theory"—a set of models that abstract from history, culture, politics, corruption, and most of the variables that a public-policy practitioner has to consider. Rather, this review examines what recent books say about why some nations grow and broadly improve the living standards of their people while others do not.

A starting point could be a very recent World Bank report[1] and book, *Strategies for Sustained Growth and Inclusive Development* (2008), which has an all-star committee endorsing it. Its part 2 begins, "We do not know the sufficient conditions for growth. We can characterize the successful economies of the postwar period, but we cannot name with certainty the factors that sealed their success, or the factors they could have succeeded without." It then goes on to say that a few good things do tend to stand out: engagement with the world economy, macroeconomic stability, a high rate of savings and investment, market allocation of resources, and credible and capable governments. There is also a short list of things *not* to do: [do not] subsidize energy, ban exports, shortchange infrastructure or public-sector salaries, use price controls to fight inflation, provide unlimited protection to selected firms or sectors, or let the exchange rate appreciate too much. It is all very sensible, but there is not anything to provide an understanding of how and why good government actually develops and remains.

Perhaps a starting point is to point out which nations have grown rapidly over an extended period. The period right after World War II was marked by a generally rapid

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rate of growth up to the 1970s. Recovery in Europe and Japan and increased global trade led to high raw material prices. Some nations, such as Brazil, used their raw materials to follow a policy of replacing imports rather than diversifying exports. This worked well for a while but ultimately was a dead end. Since 1975, Brazil's per capita growth has been less than 1 percent a year. Rich nations grow about 2 percent a year. Catching up in less than historical epochs requires at least 3 percent a year in real per capita growth.

So, which nations are growing at least 3 percent per capita since 1975? Let us begin by ignoring micronations with a population less than 1.5 million and also Japan and the "four dragons" (i.e., Taiwan, Korea, Singapore, Hong Kong), which are now rich. Briefly, there are about a dozen remaining nations that grow that fast, and most of them are Asian. The list includes Poland, Chile, Botswana, Lebanon, China, India, Indonesia, Sri Lanka, Thailand, Vietnam, and Laos.[2] On the other hand, this short list includes a lot of populous nations. These nations have a combined population of nearly three billion, or more than half the population of developing nations, and account for much of the progress in the developing world.[3] Most on the list managed at least a twenty-year doubling, and that is doing very well! Rapid economic growth is common in terms of population—indeed, it predominates—but it is uncommon among nations. Of course, if income gains are not shared, national growth will not translate into broad-based gains in welfare. This is a major concern of many development specialists.

Although broad social progress is not unequivocally and uniquely the cause of economic growth, a detour worth taking is asking if income gains are widely spread enough to matter to the bottom half or quarter of the population. Some research suggests that growth leaves relative income shares little changed, so that rapid average growth is reflected in the incomes of the poor. Others argue that globalization favors those with better skills and leaves others out. This latter argument may possibly apply to some rich nations, but the focus here is on the poor. Since income distribution data are among the least reliable, they are hard to use for comparisons over time. Instead, I will use the United Nations Development Programme's (UNDP 2007) Human Development Index (HDI), which averages index numbers for average income, education, and health. The lowest score in 2005 is about 0.33, and the highest is 0.97. Anything below 0.5 is "low human development" and indicates poor health and education levels. (Gains in health and education are pro-poor, as gains in mortality or literacy favor those less than rich.) The fast-growing large nations mostly had gains in the HDI of .20 to .24 over thirty years, while slower growing large nations had gains in the low to mid-teens. There are some exceptions: Thailand, which started with a high HDI in 1975, gained only .17, while Egypt (2.8 percent annual growth), which started low, gained more than .26. But overall, strong gains in the HDI are correlated with rapid growth rates.[4] Gains may not be spread equally, but neither are they super-concentrated. A rising tide lifts most boats, but not typically by the same amount.

The "detour" to the HDI is not without reason. Good health and education tend to support continuing gains in growth and welfare, if other conditions are also favorable. The Philippines is a poster child for a nation that has good health and education and poor growth because other conditions have not been favorable, but there are other examples. So, what prevents even healthy and well-educated nations from growing well? The profession tends to go in different directions. One group emphasizes "governance"—meaning the ability of the government to deliver services and create a stable environment for investment. The World Bank has ranked essentially all nations by six governance indicators from 1996 to 2007, and while the Philippines (for example) gets a mediocre ranking (–2.7) and has generally declined since 1996, its governance is better overall than Vietnam or Indonesia (both –3.5), both of which have grown far faster during the past thirty and fifteen years. More generally, governance is linked more with income per capita than growth rates, especially if the ratings are simply poor rather than dismal.[5] One interesting example is India, which is well ranked (–0.8) and has grown fast but still much more slowly than China (–3.2) or Vietnam, which are much less well rated. Bangladesh (–5.2) was rated among the most corrupt places on earth, but has grown at 2 percent per capita per year since 1975 and 3 percent since 1990. So, it is hard to use governance as *the* "missing" variable when it is low from some of the best performers but fairly high in some relative laggards, such as Brazil, Turkey, or South Africa. These comments do not mean that governance is irrelevant, especially if it borders on anarchy or a kleptocracy. But for those "in the middle," it is not so clearly crucial.[6]

Another view, espoused by William Easterly, is that if nations only "unleash the market" and allow private investors to operate with a minimum of interference, then growth will begin and sustain itself. It is a bit difficult to measure this, but the conservative Heritage Foundation's "Index of Economic Freedom" is certainly a first approximation in that it focuses on economic policies and laws. Here, as with governance, the results are not encouraging—and seem to be at variance with even

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casual empiricism. Are China, Ethiopia, and Bolivia really equal in terms of economic freedom? Are Ghana, Nigeria, Brazil, or Cambodia so much better than Vietnam, which is placed in the bottom fifth? (Not if per capita FDI flows or real GDP per capita growth rates are measured!) Most fast-growing nations are in the bottom half of the Freedom list, and many slower growing ones are highly rated. It again appears that per capita income predicts freedom more than freedom predicts growth. Clearly, the ability to invest securely helps, but it does not seem to prevent many poorer but relatively unfree nations from growing fast for quite a while.

Perhaps it is better to take the approach of professor Paul Collier, whose book *The Bottom Billion* (2007) asks why some nations do not grow. He describes different kinds of political–economic traps that nations fall into. They can be traps from ongoing conflict, from natural resources, from landlocked countries with bad neighbors, and from bad governance in small countries.[7] Collier argues that "capital is a coward"—that, resources such as oil aside, investors will avoid places that lack security and other desirable attributes. In other words, globalization will not rescue the least well-off, in part because many middle nations are doing pretty well. He considers aid, military intervention, laws and charters, and trade policy as ways to get very poor nations out of their traps. Certainly, for the unlucky in historic or geographic terms, this analysis is valuable and thought-provoking. It argues that to get into the race, some nations will need extra help from the world community, although examples of successful assistance are not as common as they should be.

While a billion is not a small number, it is still only about 15 percent of global population. This group may well need special interventions designed for unstable and poorly governed places. We have already noted that nearly three billion people live in nations that are growing fairly quickly, while one billion live in what are called rich nations. What about the rest? They are not the North Korea–Zimbabwe–Myanmar–Haiti type places where wealth is destroyed through incompetent or predatory government. Some, such as Brazil, had an extended period of rapid growth, but Brazil has grown at only 0.7 percent per capita per year during the past three decades despite being at peace with improving health and education and now an extended period of democratic transfers of power. By region, Latin American and Arab growth since 1975 has been 0.7 percent per capita; Sub-Saharan Africa has been –0.5%; and Central and Eastern Europe have grown at 1.4 percent a year. Excluding India, the rest of South Asia is dominated by Bangladesh (2 percent since 1975) and Pakistan (2.5 percent). How can we explain the slow growth of so many nations not in the bottom billion?[8]

It may be the time to refer to conventional wisdom. One text that summarizes it well is *Economics of Development* (sixth edition, Norton, 2006), by Perkins, Radelet, and Lindauer. The authors report in Chapter 3 on the characteristics of rapidly growing nations and have a list similar to the World Bank's and equally plausible. The first element is macroeconomic and political stability. It is unwise to invest if your factory could be destroyed or taken over or the profits are impossible to guess at because of high inflation. Investing in health and education makes workers more productive in a "normal" country. Capital tends to follow skills if other things are equal. One of the equalizers is governance—the ability of the state to create markets and regulate, stabilize, and legitimize them efficiently. A poor country need not look like a rich one from the start, but investors need to believe that the state will accommodate rather than prey on capital. Participating in the global economy, if combined with the previous characteristics, will allow specialization and technical change to occur and also foster competition. However, if a country is landlocked and faces costly transportation, even an "open" economic policy may not be so productive. Geography counts for something, although infrastructure and policies can offset many negatives.

This list is not complete. A country that starts out highly unequal may have a hard time spreading health and education *and* making opportunities widely available. Little is said about the financial system—often a real barrier to efficient capital allocation. Having a high savings and investment ratio may not help much if a lot of the effort is wasted. Just being poor can actually help a little—there is a lot of easy catching up, if the policies are right. It is a lot trickier getting from $5,000 to $15,000 per capita income than from $500 to $5,000.[9] But is this list, or one like the World Bank's, all that can be said?

Perhaps the reason that development is not entirely comfortable inside economics is that it always requires some special knowledge. Turkey, for example, does a lot right. It has had some military takeovers, but not recently. Its governance sums close to zero (as opposed to being highly negative), or a score close to the median. Its corruption score is cleaner than average. Its human development index is just better than Sri Lanka's and close to that of China's—so health and education are good. It is close to many wealthy markets with good ocean connections. It has many workers in Europe, and its multinationals are active in the region. It saves and invests about a quarter of its income. Yet, per capita

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growth in the past thirty and fifteen years is 1.8 percent and 1.7 percent, respectively—slower than the average of the rich nations. Turkey's per capita income (PPP) of $8,000 makes it middle income. Yet, it has not been able to convert these real advantages into even 3 percent annual per capita growth. It would have to double its growth rate to equal Indonesia's—a country that has done more poorly in many respects. The wars against Iraq have not helped Turkey, disrupting a major trading partner. Kurdish separatism and Islamic attacks flare up from time to time. Inflation has been high. Yet, even with these negatives, it is hard to understand why such a sophisticated society and capable nation have not done better.

In the end, it may be that to sustain rapid growth, growth has to be a serious priority of the governing elites. This is a flawed observation, in the sense that it is circular. Unless there is a way beforehand to tell if economic growth is a serious priority, the only way to know is if the country grows fast over time. It is also possible that elite priorities may change over time, or economic conditions could change. Interest groups might agree on a policy that works well for a time but then becomes less effective as potential sources of growth change.[10] Most interest groups are worried about their relative share of power and/or wealth, more than the rate of overall growth. If national security is threatened, or if the regime needs growth to legitimize itself, then a nation may be willing to make the difficult decisions required to keep growing. Even if this observation is accurate, it does not give an outsider much policy leverage. Getting to know the elites and becoming a player is not a three-year assignment! For a privileged insider, a quiet life or one that is spent comfortably may well be preferable to fighting vested interests so that growth can continue.

Indeed, one aspect not yet considered (and not widely appreciated) is the role of global alternatives for potential change-agents. Albert Hirschman, in his classic *Exit, Voice and Loyalty*, spoke of various rational responses to institutional failure. If there is a well-educated young person with some position in a potentially developing nation, how hard does that person fight to reform things in his or her country? It depends, in part, on how easy it is to go and have a life somewhere else. From a personal point of view, many will prefer to take their skills to where they are better appreciated, compensated, and further developed. Globalization of talent may lead to "badly run places" losing talented people—this can even happen within a nation. It may be that unless there are some barriers to movements of well-qualified labor, reform will be difficult in places where the elites do not want to rock the boat, even if it is leaking. Perhaps South Africa, Turkey, and Brazil—among others—do not grow faster because they do not have to and their elites are sufficiently discouraging to reformers, who either leave the country or "retire" to a quiet life without moving.[11]

In the end, rapid and sustained growth is a political choice and often a difficult one. It is not hard to understand what needs to be done technically, but it is very hard to get the policies adopted and implemented well when they are unpopular with those that would be hurt, at least at first and perhaps for even longer. Economists are not very good at analyzing coalitions of interest groups, except perhaps as they relate to fairly narrow policies (Olson 2000). Political scientists are better at observing these groups but to date lack strong predictive tools and are not accustomed (or perhaps competent) to play a role in economic policy making. This leaves the development field with lists of desirable characteristics but no way to get there except to hope that the governments will decide to act in the long-run interest of their countries. As long-run problems such as the environment, both local and global, become more important,[12] the challenge to initiate and sustain growth will continue to be a challenge to which some will find a way to respond and at which many will fail, usually while blaming others.

Notes

1. Martin Wolf, in his *Financial Times* column, June 4, 2008, made this observation and the list of goods and bads.

2. The list excludes Myanmar; it claims fast growth, but its data are not reliable.

3. There are a number of medium-sized economies (Poland, Chile, Malaysia, Sri Lanka, Taiwan, Mozambique, and Uganda) and some other smaller ones that also grew faster than 2 percent over thirty years. Large nations growing at 2 percent to 3 percent included Egypt, Pakistan, and Bangladesh.

4. This is not surprising. Within Asia, the bottom 20 percent receives from 4.4 percent to 8.9 percent of income in the various fast-growing nations, and these shares change only slowly. If real incomes double every ten to twenty years, it would take astonishing changes in within-country distribution for the bottom groups not to benefit over time. In Africa and Latin America, the range of income shares for the poorest fifth tend to be lower (1.5 percent in Bolivia and 1.1 percent in Sierra Leone are extreme; Brazil, at 2.6 percent, is not), and growth tends to be slower. So welfare gains are not as inevitable. Clearly, welfare gains *are* possible with limited income growth—but much less certain. For example, Bolivia's HDI gained .18 despite near-zero growth.

5. Each of the six scores has a median of zero and roughly a +2 or –2 range (equivalent to standard deviations), with a few scores outside of that range. The sum of six scores is reported for 2006 in the data given above. To put this in perspective, Myanmar's sum of indicator rankings in 2006 is about –10.0, and Iceland's is +11.3.

6. Another possibility is that these governance indicators do not capture the crucial aspect of governance.

7. Collier makes several important points. One is that corruption need not prevent fairly good economic policies. In a big country, the

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policies initially require only “letting go” rather than detailed implementation. In a small and poorly located nation, even clean government and good policy may only allow the nation to reach its low potential. In a resource-rich poor nation, success requires more than “letting go.” These qualifications could help to explain the poor correlation of governance and growth.

8. While many of Collier’s “bottom billion” are in Africa, Ghana has been a major aid recipient and at peace with a reasonable government. Since 1990, it has grown at 2.0 percent a year. South Africa, the economic giant, has had only 0.6 percent growth since 1990. Only Botswana, Sudan, Uganda, and Mozambique have grown more than 3 percent a year since 1990, of the Sub-Saharan nations more than 1.5 million.

9. These refer to purchasing power parity (PPP) income per capita levels. Nigeria and India have a PPP per capita of about $2,000; China of $4,000; and Brazil, Turkey, and South Africa of $8,000 to $9,000.

10. This might explain the long period of import-substituting growth in Brazil and the subsequent stagnation.

11. Some will elect to enter the nongovernmental organization (NGO) sector. This sector can alleviate suffering and may influence policies, but to date, it is not a major player.

12. The environment has been growing in importance as a goal in democratic nations with a middle class that wants clean air and water and as a constraint in many other places where public health and product safety suffer because of a toxic environment caused by “dirty” growth choices. Global warming will become an even larger consideration going forward and will no doubt eventually influence investment, technology, and product choices in developing nations. The argument that they “deserve” a free pass on carbon emissions because of their low per capita levels of use is correct but irrelevant. Global warming will hit most developing nations harder than it will the rich ones. If they emit more, they will suffer more, even as the rich find ways to cut their carbon emissions. Technology development and licensing and subsidies for conservation will be needed to control carbon emissions, along with increased use of low carbon fuels or carbon capture.

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