What it all means
20th century economic growth is a tale of divergence and convergence

- Why modern economic growth began first in Europe and its overseas offshoots is still not entirely understood: many factors, ongoing debate.*
- Why it was slow to spread to other parts of the world is a second complex question: observers point to geographical disadvantages, the legacy of colonialism, cultural variables, and many other factors.
- Whatever initiated the process, declining transport costs then allowed early industrializers to exploit economies of scale (to enjoy agglomeration effects), which worked to deindustrialize the rest of the world, and accentuate divergence.
- As a result, in the first era of globalization the benefits were unequally shared.

More recently, there are growing indications of convergence, although there remains dispute over its durability and extent (about who is included in the “convergence club”).

- Independence allows new nations eventually to shed the burden of colonialism.
- Technical change helps to overcome the burdens of geography.
- Decline in costs of information and corporate control has allowed economies of scale and scope to be reaped without concentrating production in one place (global production chains, offshoring, outsourcing, etc.)
• In principle, all this allows the benefits of the second age of globalization to be widely shared.

– This encourages an optimistic rendering of recent experience. China, India, Latin America, Central and Eastern Europe, and even parts of Sub-Saharan Africa and the Middle East all now appear to have joined the Convergence Club.
And there are considerable grounds for optimism
And here too, aside that is from the transition economies and Sub-saharan Africa
• But the obstacles to development and convergence are deeply embedded.
  
  – Institutions with deep historical roots are hard to change.
  – Special interests that benefit from growth-stifling policies resist reform.
  – There are still many countries that appear to be left behind.
Standard policy prescriptions are not always helpful

- Where markets and mechanisms for corporate governance are weak, simply saying “privatize state enterprise” or “deregulate banks” can be counterproductive (viz. the Asian crisis)
- More generally, Washington Consensus prescription leads to reform fatigue and overloads the political system. It fails to identify and prioritize binding constraints. The emphasis on institutions in Washington Consensus II only aggravates this problem. The historical determinism about institutions in some recent research further reconciles policy makers to failure.
- These points are reinforced by recent growth experience, which is hard to reconcile with the view that adherence to the Washington Consensus stimulates faster growth.
These points are evident in the next two slides

- The first one shows that Japan, South Korea and China have been the growth leaders in three recent periods. All of them departed significantly from the Washington Consensus.

- The second one shows that East Asia, which has departed even more dramatically than other regions from that Consensus, has outperformed other regions consistently.
Source: Maddison (2001) and World Development Indicators.
Economic growth

Source: World Development Indicators
• These objections are valid and important, but what to do in response is less clear.

– Saying “address institutional problems and root out political resistance to reform” is little more than to assume a solution to the problem.
Implications

• Markets don’t always get it right.
• Especially when there are missing and distorted markets, there may be a role for unconventional interventions.
  – The now-advanced countries all intervened in the operation of their economies (the US in the 19\textsuperscript{th} century with trade restrictions, Japan with government firms in manufacturing in the 19\textsuperscript{th} century and selective industrial targeting in the 20\textsuperscript{th}, Europe with nationalization and indicative planning) in ways that would horrify the proponents of the Washington consensus.

• Exactly what interventions are appropriate will depend on what markets are missing or distorted.
  – This is an argument against one-size-fits-all advice.
But these kinds of observations can be a justification for absolutely any intervention. They can provide a justification for growth-promoting policies, but they can also be cover for capture by special interests; they can be a license for grow-suppressing policies that simply redistribute the wealth.
What then ensures that appropriate interventions are selected?

- It is tempting to answer: “the political system.”
- Some would argue that a “strong state” (as in China) is best able to face down special interests and adopt appropriate interventions.
- But for every China there is also a Philippines (remember Imelda Marcos and her shoes) and an Indonesia (remember Suharto and his billions).
- Some would argue that democracy is best for imposing checks and balances on those who would capture the process.
- But democracy can also empower special interests (think campaign contributions).*
- Empirically, as we have seen, there is no correlation between the political system (democracy vs. authoritarianism) and economic growth.

• Evidently the same political system delivers different outcomes under different circumstances.
  – Perhaps history matters.
  – Perhaps external circumstances matter. Many strong states that have pursued pro-growth policies faced external threats (South Korea, Taiwan, Hong Kong).
  – Perhaps geography matters (openness constrains special interests*, and Korea, Taiwan and Hong Kong had no choice but to be open).

• These are hard questions that define the frontier of social-science research and thinking.
• We cannot provide answers for all of them in this course.
• But we can at least make the case for thinking about them historically.