Looking at the Barriers to Growth in a Country

William Easterly and 'the Elusive quest for growth'

As William Easterly himself puts it, "the quest for a theory of growth and development has tormented us economists as long as there have been economists." Ever since the 18th century, one of the most pressing economic problems has been to **try identify a metric and a theory for the growth of a country**. There have been many theories put up my famous economists, trying to comprehend growth and development. In 'The Elusive Quest for Growth', Easterly looks at some of these theories and the popular question of why some countries fail to achieve economic growth.

It's funny how Easterly, who is a privileged Professor of Economics at New York University, is attempting to study third world poverty! Of course, economists started paying attention to the problems of poor countries only after World War II, and many came up with theories to show these countries could grow and catch up to the rich.

The Harrod - Domar model stated that **growth was directly proportional to investment**. More investment in machinery and capital would directly result in more growth. People during the world war II thought of capital as 'machines'. This model relied on the simple prediction that GDP growth is proportional to the share of investment spending in GDP. Domar assumed that the change in GDP would be determined by the change in number of machines. Domar himself disavowed his own theory eleven years later, saying that it wasn't a meaningful growth model. Easterly examines how ironic it is that **even though the creator himself repudiated his theory, it still became the most widely applied growth model in history!**

Economists applied the Domar model to many poor countries to determine the investment rate for the target growth rate. Easterly explains the financing gap as "the difference between the required investment and the country's own savings". But was it practically possible for poor third world countries to actually be able to invest so much in machinery? There was an inevitable financial gap, and the best way to approach this was with **financial aid.** The economists believed that **the western donors must provide 'foreign aid' to these poor countries and fill up the financing gap!** Walt Rostow strongly advocated for foreign aid and he came up with 'The Stages of Economic Growth'. One of the stages was the 'take-off' stage, analogous to an airplane taking off from the runway. Rostow said that for a country to be able to take off, it needed that push from investment in machinery and required help from foreign countries to fill the financial gap with aid. He gave the example of

Stalin's Russia and how so beautiful fit the takeoff theory. (Of course, Easterly mocks this later, saying that the Soviets had 'fooled them for so long' and that growth has been negative ever since 1990).

The Domar Model was heavily applied in **Ghana**. After independence, a huge hydroelectric dam was built, which created the world's largest man made lake - Volta. With aid and investment, Ghana was successful in building an aluminium smelter and electricity generator. But, as Easterly puts it, the real disaster is that **the Ghanaians are still as poor as they were in the 1950s**. There were food shortages and cases of malnutrition across the country. Per capita income fell and the investments did not really lead to any growth of the country. Similar case was observed in Guyana, where even though investment and foreign aid only increased, the total GDP fell sharply from 1980 to 1990. Yet, the World Bank argues that Guyana needs foreign capital inflows. **Easterly humorously says that 'That didn't work, so let's try again!'.**

The theory clearly failed. It's confounding how Walt Rostow and other economists kept advocating for the financial aid and the Domar model of growth, even after Domar had completely rejected his theory himself! One of the reasons for the failure of the model was that the economists **assumed a fixed ratio between the people and machines**. Labour was assumed to be 'unlimited' and machines were the binding constraint on the production. Foreign aid also had another problem problem of repaying debts. The only way to tackle the debt problem was to increase national saving.

Physical capital may be seen as a necessary condition for development, but in no way is it **sufficient**! Easterly says that there is no evidence that investment is a sufficient condition for growth, but he argues that investment is not the casual force, **technology is!** There will be more investment in machines, but also in adaptation of new technologies and education and efficient institutions!

Easterly thus argues against capital fundamentalism, and also supported his claim with the law of diminishing returns. He gives the example of a pancake, saying that he needs to mix some milk into the batter to give the pancake a good texture. But he can't keep adding milk to it after a certain limit as it would just make them thinner, ruining the taste and texture. Increasing one ingredient while the other is unchanged does not enable sustained growth. When there are already plenty of machines, an additional machine would increase the output very little. The capital fundamentalists were hell bent in the ideology that you have to invest!

The law of diminishing returns gets even more complicated with technological leaks. For instance, the Desh Factory in Bangladesh! The Koreans were training labour, and after acquiring all the skills, they broke free. Another example is that of Korea and Japan, where they make their own mobile chips - another result of a technological leak. William Easterly

also spoke against Education fundamentalism, saying that only education does not lead to growth, and there is enough evidence to support the claim. The sub-saharan African countries have a massive schooling system, but clearly are not developed countries.

The bottomline is that investment alone cannot be the source of growth. It may be necessary, but is certainly not sufficient. Easterly says that there is more capital in richer economies, simply because the **technological progress offsets diminishing returns!** Technical change avoids diminishing returns if it saves on labour. Each worker becomes more efficient due to better technology. **"The effective number of workers keeps up with increasing number of machines, so diminishing returns never sets in!"**

That's Easterly's take on growth of poor countries, and he strongly contradicts economists such as Jeffrey Sachs and other capital fundamentalists. Another factor that I believe is relevant here is - **Development as Freedom**. Amartya Sen talks about growth and development as freedom! I think ties in very well with Easterly's argument because both believe that investment and machinery is **only a 'means' of development - not the end!**

The Domar model fails because it looks at investment as the 'ends' of development, and not the 'means'. Amartya Sen says that a great GDP does not necessarily imply that the country is developed. Yes, a high per capita income is a way to reach development, that is, it is the 'means' to reach development. **But it is not the 'end' itself!**

Amartya Sen wanted to rethink the very definition of development. He said **development is freedom**, and his theory focuses on the 'ends' rather than the 'means' of development. One must have access to education, healthcare and drinking water. There must be freedom in the civil and political rights of the people. It is the lack of freedom that actually leads to poverty. These are the 'direct indicators' that really define the 'ends' of development. Yes, GDP is an important means to reach development, but along with that, we also need entitlements and capabilities **so that the means can lead to the ends.** Investment and Machinery are means of development, but not the end itself.

"It's Technology, stupid" - this pretty much describes Easterly's solution to the Domar model. Technological change was progressively economise on labour and keeps making that fixed amount of labour go even further. In the long run, growth of production per worker has to be labour-saving technical change.

And that in my humble opinion, would be a very strong reason to lend the course its name - ICT's for Development!