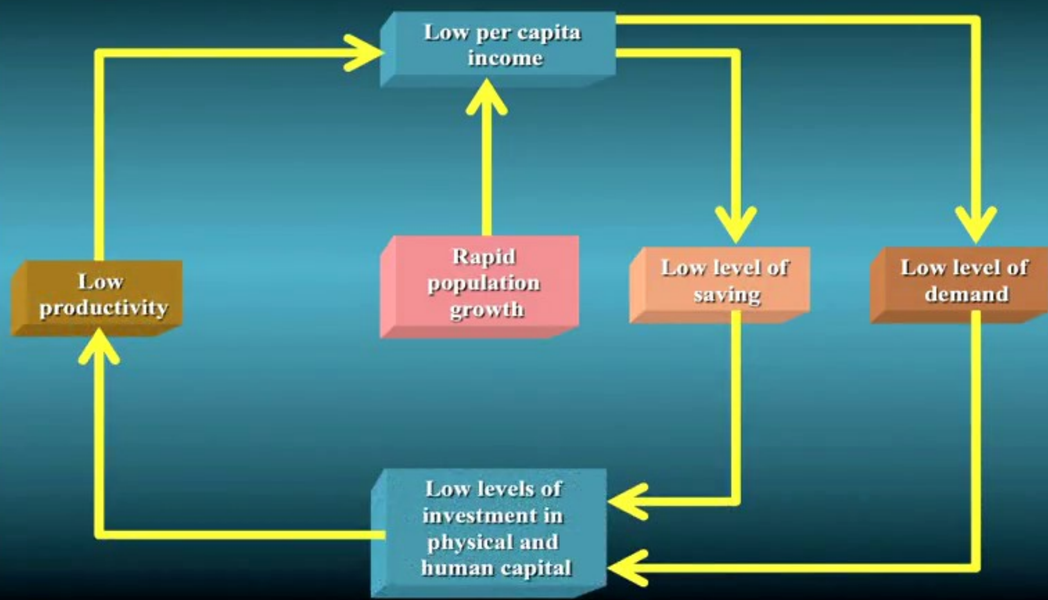
LECTURE ELEVEN - PART FOUR

Why Do Some Countries Prosper?

- Let's better understand why some developing countries prosper while others stagnate.

The Cycle of Poverty



Education, Literacy, and Skill

- Poverty is accompanied by low levels of education, literacy, and skill.
- These elements prevent the adoption of new and improved technologies.

Overcoming Barriers of Poverty

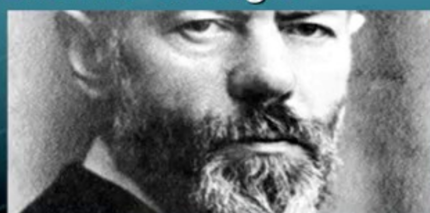
- Some development economists recommend a "big push" forward to break the vicious cycle.
- Simultaneous steps to invest more, improve health and education, develop skills, and curb population growth can break the vicious cycle of poverty and stimulate a virtuous circle of rapid economic development.

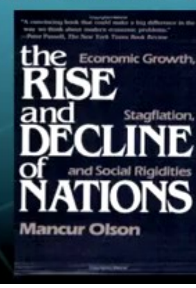
Some Answers

- Economists, historians and social scientists have long been fascinated by the differences in the pace of economic growth among nations.
- Some early theories stressed a hospitable climate, noting that all advanced countries lie in the earth's temperate zone.
- Others have pointed to custom, culture, or religion as a key factor.

Max Weber and Mancur Olson

- Max Weber, for example, emphasized the “Protestant ethic” as a driving force behind capitalism.
- Mancur Olson: Nations begin to decline when their decision structure becomes brittle and interest groups or oligarchies prevent social and economic change.





These Theories Are Not Universal

- No doubt each of these theories has some validity for a particular time and place.
- But they do not hold up as universal explanations of economic development.

What They Don't Explain

- Weber's theory leaves unexplained why the cradle of civilization appeared in the Near East and Greece while the later-dominant Europeans lived in caves, worshiped trolls, and wore bearskins.
- Where do we find the Protestant ethic in bustling Hong Kong?
- How can we explain that a country like Japan, with a rigid social structure and powerful lobbies, has become one of the world's most productive economies?

More Modern Views

- The failure of these early theories to fully explain economic development have spawned more modern views.
- Here's a sampling of the debate over how countries might break out of the vicious cycle of poverty and begin to mobilize the factors of economic development.

Industrialization vs. Agriculture

- A strategy of rapid industrialization or expanding and improving the agricultural base?
- In the past, such a choice was typically resolved in favor of industrialization.
- Today, many analysts are rethinking the role of farming.

Industrialization vs. Agriculture

- Industrialization is capital intensive, attracts workers into crowded cities, and often produces high levels of unemployment.
- Raising productivity on farms may require less capital, while providing productive employment for surplus labor.

Example

If Bangladesh could increase farming productivity by 20%, that advance would do more to release resources for the production of comforts than would trying to construct a domestic steel industry to displace imports.

A State vs. Market Economy

- The important elements of a market-oriented policy include:
  1. An outward orientation in trade policy
  2. Low tariffs and few quantitative trade restrictions
  3. The promotion of small business
  4. The fostering of competition

> Key Point
> Markets work best in a stable macroeconomic environment—one in which taxes are predictable and inflation is low.

Hostile Cultures

- The cultures of many developing countries are hostile to the operation of markets.
  - Often, competition among firms or profit-seeking behavior is contrary to traditional practices, religious beliefs, or vested interests.
- Decades of experience suggest that extensive reliance on markets provides the most effective way of managing an economy and promoting rapid economic growth.

Growth and Openness

- Should a developing country pursue a strategy of import substitution by replacing most imports with domestic production?
- Or should a country pursue a strategy of openness or outward orientation?
- Should it pay for its imports by improving efficiency and competitiveness, developing foreign markets, and keeping trade barriers low?

Import Substitution

- Policies of import substitution were often popular in Latin America until the 1980s.
- The policy most frequently used was to build high tariff walls around manufacturing industries so that local firms could produce and sell goods that would otherwise be imported.

A Policy of Openness

- Keeps trade barriers as low as practical, relying primarily on tariffs rather than quotas and other nontariff barriers.
  1. Minimizes interference with capital flows and allows supply and demand to operate in financial markets.
  2. Avoids a state monopoly on exports and imports.
  3. Keeps government regulation to bare necessities for an orderly market economy.
  4. Relies primarily on a private market system of profits and losses to guide production, rather than the commands of a government planning system.

The Asian Countries

- A generation ago, countries like Taiwan, South Korea, and Singapore had per capita incomes one-quarter to one-third of those in the wealthiest Latin American countries.
- Yet, by saving large fractions of their national incomes and channeling these to high-return export industries, these countries overtook every Latin American country by the late 1980s.

The Secret To Success

- The secret to success was not a doctrinaire laissez-faire policy -- the governments engaged in selective planning and intervention.
- The openness and outward orientation allowed the countries to reap economies of scale and the benefits of international specialization.
- This allowed them to increase employment, use domestic resources effectively, enjoy rapid productivity growth, and provide enormous gains in living standards.

Policies For Promoting Growth

1. Establishing the rule of law.
2. Opening economies to international trade.
3. Controlling population growth.
4. Encouraging foreign direct investment.
5. Building human capital.
6. Making peace with neighbors.
7. Establishing independent central banks.
8. Establishing realistic exchange-rate policies.
9. Privatizing state industries.

The Role of Industrialized Nations

- Industrialized nations can provide more foreign capital – both public and private – and better target such aid to the poorest developing countries.
- The United States and many other industrialized nations already assist the developing countries with substantial foreign aid in the form of both loans and grants.

Eliminate Trade Barriers

- This would allow developing countries to expand their national incomes through increased trade.
- But such a step can be politically controversial because it raises the specter of industrialized workers having to compete against people willing to work for a dollar or less a day.

Provide Debt Relief

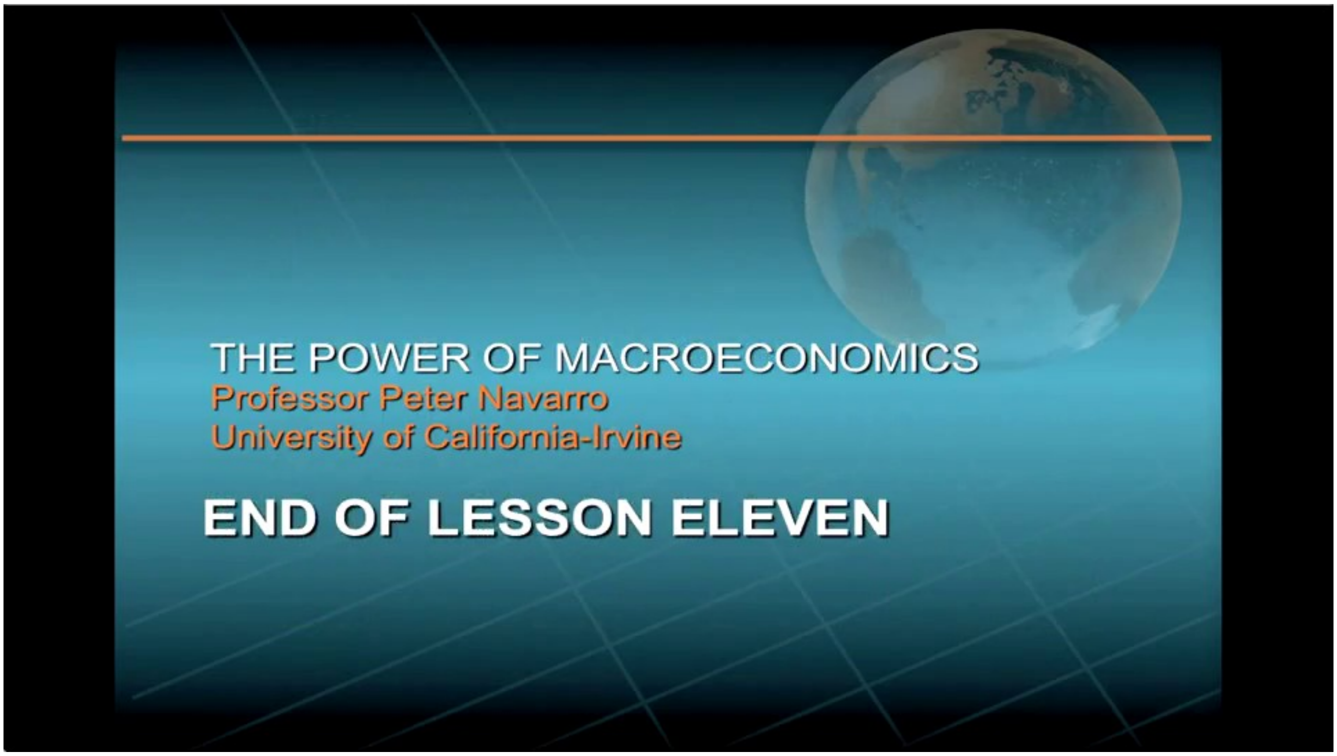
- The problem here is that the current debt load of many developing countries is so large that monies which would otherwise go to investment in the countries has to be used for servicing these debts.

Stop The Brain Drain

- Many of the best and brightest workers in the developing countries come to the industrialized nations temporarily to get an education but wind up staying permanently to work.
- This brain drain contributes to the deterioration in the overall skill level and productivity of labor forces often least able to suffer such losses.

Discourage Arm Sales

- While arms sales create jobs and profits in the industrialized nations, they also divert precious public expenditures from infrastructure and education in the developing countries.


THE POWER OF MACROECONOMICS
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