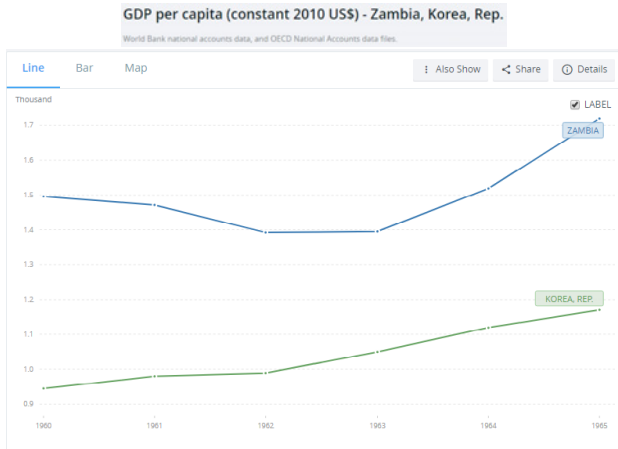


# Applications: Development

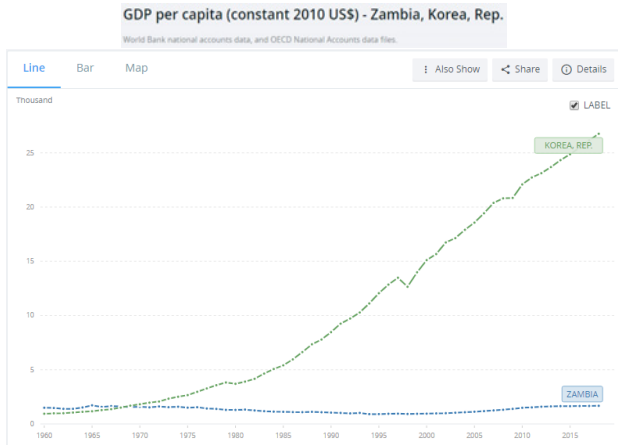
# Causes of the Wealth and Poverty of Nations

In 1964, the African nation of Zambia and the East Asian country of South Korea were at similar levels of development.



# Causes of the Wealth and Poverty of Nations

In 1964, the African nation of Zambia and the East Asian country of South Korea were at similar levels of development.



# Causes of the Wealth and Poverty of Nations

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Today:

Zambia's GDP p.c. is \$1,000.

South Korea's GDP p.c. is \$31,000.

(United States' GDP p.c. is \$63,000.)

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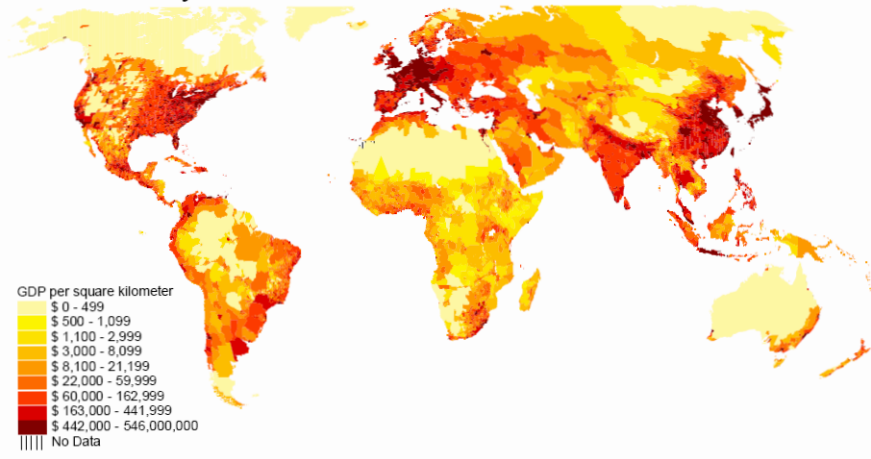


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Lusaka, Zambia vs. Seoul, South Korea

## GDP Density



# If Everyone Wants Development, Why Is It So Hard to Achieve?

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Possible explanations:

- ▶ Geographic location
- ▶ Domestic institutions
- ▶ International forces/other countries
  
- ▶ Not everyone wants development!

Key question:

**Which is most important for development?**

# Geographic Location

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Geography and climate can affect development.

- ▶ Access to natural resources, fresh water
- ▶ Extreme temperatures
- ▶ Propensity for disease

But, wide variation in development within the same region, so others things at play.

# Domestic Politics

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Policies impact economic growth. How?

Governments can provide public goods that can increase development

## **infrastructure:**

- ▶ Physical infrastructure (roads, airports, ports, etc.)
- ▶ Economic institutions (financial systems, etc.)
- ▶ Social infrastructure (public health, education, etc.)

## **protection of private property rights**

- ▶ individuals have incentives to make economic investments



# Domestic Politics

---

Review: What models explain why public goods are hard to provide?

## **Selectorate Theory**

Ex: Everyone generally benefits from stable economy with property rights. But wealthy landowners may not want property rights for poor farmers. . . so certain actors have interests that slow economic growth.

What types of domestic systems will provide property rights?

**Good institutions** though not necessarily democracy.

Exacerbating factor: Ethnic and religious divisions

# Resource Curse

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Why are regions rich in natural resources poor and underdeveloped?

- ▶ **Resource curse:** initial wealth gives rise to ensuing poverty

*Government in a country with few natural resources:* implements measures to increase productivity

*Government in a country with many natural resources:* less incentive to increase productivity, less democratic bc. citizens can be bought off with low taxes.

# International Factors

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## How do rich countries affect poor countries?

Incentives for cooperation between rich and poor countries:

- ▶ All benefit from international trading, financial and monetary systems, combating disease, etc.

But interests of rich and poor countries often conflict.

- ▶ Colonialism
- ▶ Protection of domestic interest groups in rich countries

# Colonialism

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Imperial powers exploited their colonies, enslaved people, extracted resources.

Two trajectories (from Acemoglu, Johnson, and Robinson):

1. high settler mortality → extractive institutions → low growth
2. low settler mortality → good institutions → high growth

# Are international markets good or bad for less developed countries?

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Competing views:

- ▶ LDC's systematically disadvantaged
- ▶ Globalization inherently good for LDC's

## Argument: International Markets are Bad

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Raul Prebisch (1950s), Argentine economist: “dependency theory”  
trade is bad for interests of developing countries

*LDCs mainly sell primary products:*

- ▶ Many producers so competitive markets force prices of these goods down

In contrast, manufactured goods were controlled by a few large **oligopolistic** firms, keeping prices high.

Result was terms of trade shifts:

- ▶ Developing countries pay more for imports, get paid less for exports
- ▶ Is this exploitation?

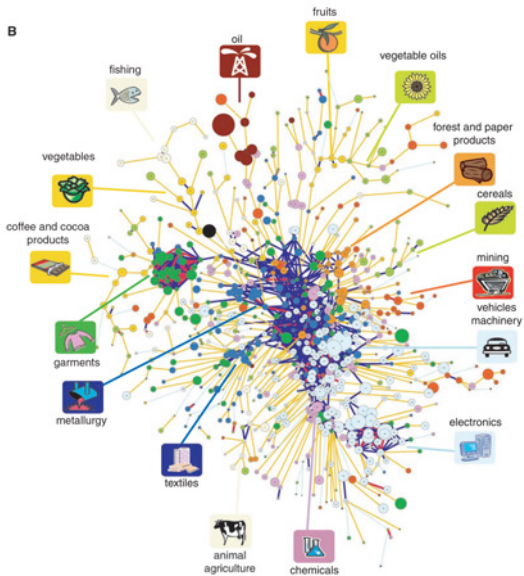
# Import-Substituting Industrialization (ISI)

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- ▶ Erect trade barriers to protect selected industries
- ▶ Government incentivizes domestic investment in industry
- ▶ Government provides electric, telecomm, transport, etc

Definitely serves interests of key domestic constituencies.

# The Product Space



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# The Product Space

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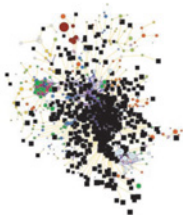


Industrialized Countries



East Asia Pacific

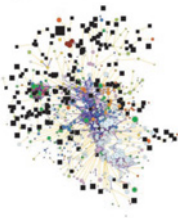
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Latin America and the Caribbean

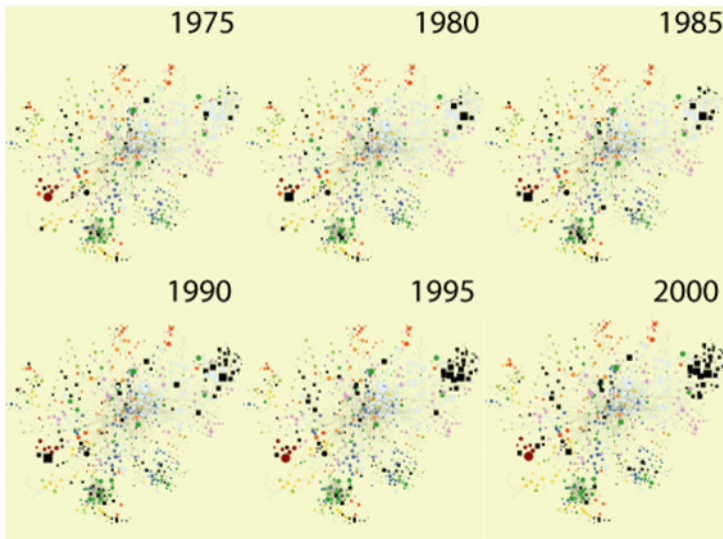


Sub-Saharan Africa



# The Product Space: Malaysia

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# Failures of ISI

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Import substitution has serious weaknesses and is abandoned by most countries:

- ▶ protected industries aren't efficient or viable
- ▶ firms have incentives to lobby for continued support rather than “graduate”
- ▶ selling to small, poor domestic market has limits

“Asian Tigers” take the ISI strategy but make it export-oriented.

# Washington Consensus

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Term coined by economist John Williamson in 1989.

- ▶ Trade liberalization
- ▶ Privatization
- ▶ Openness to foreign investment and capital flows
- ▶ Keep deficits and inflation low

Some argue that Washington Consensus is bad for LDCs

# Washington Consensus is not so bad for LDCs

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Paul Krugman, economist, “In Praise of Cheap Labor”



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“While fat-cat capitalists might benefit from globalization, the biggest beneficiaries are Third World workers.”

## Paul Krugman, “In Praise of Cheap Labor”

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Global poverty was not recently invented for the benefit of multinational corporations.

- ▶ Twenty years ago developing countries were primarily exporters of raw materials and importers of manufactures.
- ▶ Inefficient manufacturing sectors served their domestic markets, sheltered behind import quotas, but generated few jobs.
- ▶ Population pressure pushed peasants into cultivating ever more marginal land or seeking a livelihood in any way possible.

## Paul Krugman, “In Praise of Cheap Labor”

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Lower tariff barriers, improved telecommunications, and cheaper air transport reduced the disadvantages of producing in developing countries.

- ▶ Low wages allowed developing countries to break into world markets.
- ▶ Workers paid very little and expected to endure terrible working conditions.
- ▶ However, the growth of new export industries has led to measurable improvement in the lives of ordinary people.

## Paul Krugman, “In Praise of Cheap Labor”

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The growth of manufacturing and other new jobs has a ripple effect throughout the economy.

- ▶ Pressure on the land becomes less intense so rural wages rise
- ▶ Pool of unemployed urban dwellers shrinks
  - ▶ Factories start to compete with each other for workers and urban wages also begin to rise
- ▶ Hundreds of millions of people moved from abject poverty to something still awful but nonetheless significantly better.



## Conclusion

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Development arises out of a mix of at least three factors

- ▶ Natural endowments (geography, minerals, etc.)
- ▶ Domestic political and economic institutions (protection of private property, power of interest groups)
- ▶ International forces and external actors (colonialism, externalities from trade policies)

Ongoing debate about whether globalization is good or bad for the world's poor

COVID-19: the rich more connected to the problems of the poor in a globalized world.

## Debate: Foreign Aid

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Can developed countries help out with transfer of resources?

- ▶ Aid helps development?
- ▶ Aid hinders development?

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