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.

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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

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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Lusaka, Zambia vs. Seoul, South Korea
If Everyone Wants Development, Why Is It So Hard to Achieve?

Possible explanations:

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

Key question:
Which is most important for development?
Geographic Location

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

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

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

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

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

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

1. high settler mortality $\rightarrow$ extractive institutions $\rightarrow$ low growth
2. low settler mortality $\rightarrow$ good institutions $\rightarrow$ high growth
Are international markets good or bad for less developed countries?

Competing views:

- LDC’s systematically disadvantaged
- Globalization inherently good for LDC’s
Argument: International Markets are Bad

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)

- 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
The Product Space
The Product Space: Malaysia
Failures of ISI

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

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

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

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

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.
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

Can developed countries help out with transfer of resources?

- Aid helps development?
- Aid hinders development?