Chapter 10
Development: Causes of the Wealth and Poverty of Nations
The realities of contemporary economic development:
• Billions live in conditions of poverty
• Development experiences have varied widely
What Do We Know? Relative Wealth
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.
- Today, Zambia is a development disaster while South Korea has become an industrial nation.
Core of the Analysis

- Why have some countries developed successfully while others have not?
  - Geographic location
  - Domestic factors
  - Domestic Institutions

- Are rich countries responsible for the problems of the developing world?
  - Colonialism?
  - Bias of the international economy?
  - Bias of international institutions?

- A quick overview of development politics
If Everyone Wants Development, Why Is It So Hard to Achieve?

- Less developed countries (LDCs) want to develop.

- Three factors help explain why this goal is so hard to attain:
  - Geographic location
  - Domestic factors
  - Domestic institutions
Geographic Location

- Climate and geography affect development according to their impact on a nation’s people, social structures, politics, and policies, but there is a great deal of variation.

- E.g., *Guns, Germs, and Steel: The Fates of Human Societies* (Jared Diamond):
  - *Gaps in power and technology between human societies originate in environmental differences and geography, not genetic or intellectual differences.*
  - Environmental advantages of Eurasia over Sub-Saharan Africa.
Domestic Factors

- Governments can increase development by providing public goods

- One public good is economic infrastructure:
  - Physical infrastructure (roads, airports, ports, etc.)
  - Economic institutions (financial systems, etc.)
  - Social infrastructure (public health, education, etc.)

- Governments can also commit to protect private property.

- A government should provide people with credible commitments that it will provide beneficial public goods and that it will maintain political/economic stability.
Domestic Factors

- Certain actors may have certain interests that can slow economic growth.
  - E.g., wealthy landowners may want poor farmers to not be protected by property rights
  - E.g., development policy in sub-Saharan Africa has largely benefited small groups at the expense of the masses.
Domestic Factors

- Social groups, politicians, and the public fight, bargain and cooperate toward an outcome and determine a government’s policies toward development.

- Ethnic, religious, and racial features of a population affect economic policy.
  - The larger the group, the more difficult collective action becomes
  - E.g., Easterly: ethnic fragmentation $\rightarrow$ development (e.g., Africa); ethnic homogeneity $\rightarrow$ development (e.g., East Asia)

- The existence of a powerful common national goal may lead groups to set aside differences and work towards development.
  - E.g., North Korea vs. South Korea; China vs. Taiwan
Domestic Institutions

- Comparison of North America and South America:
  - Both were colonized at about the same time; South America gained independence within decades of North America

- However, the kinds of economic activities that each region adopted created a lasting economic impact.
  - North America: small-scale farming → independent family farmers → democracy
  - South America: plantation agriculture and labor-intensive mining → wealthy landowners/miners vs. poor workers/slaves → biased institutions
Domestic Institutions

- Why are some regions that are rich in natural resources poor and underdeveloped?
  - “Resource curse” theories predict that initial wealth gives rise to ensuing poverty
    - E.g., Nigeria (oil), Zambia (copper)
  - A government of a country with few natural resources must implement measures that will make a country more productive.
    - E.g., Singapore, Taiwan

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<tr>
<th></th>
<th>Zambia</th>
<th>Botswana</th>
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<tr>
<td><strong>Geographic Location</strong></td>
<td>• Southern Africa</td>
<td>• Southern Africa</td>
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<td></td>
<td>• Landlocked</td>
<td>• Landlocked</td>
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<td>• Mineral Wealth</td>
<td>• Mineral Wealth</td>
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<tr>
<td><strong>Domestic Factors/Institutions</strong></td>
<td>• Nationalization of private investment</td>
<td>• Private investment encouraged</td>
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<td></td>
<td>• Discrimination against farmers</td>
<td>• Provision of public goods</td>
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<tr>
<td><strong>Colonialism</strong></td>
<td>Former colony of Great Britain → Independent in 1964</td>
<td>Former colony of Great Britain → Independent in 1966</td>
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- At independence, Zambia was much richer than Botswana.
- Today, Botswana has a GDP per capita of about $6,000 while Zambia’s is about $600

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<th>Burma</th>
<th>Thailand</th>
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<td>Geographic Location</td>
<td>• Southeast Asia</td>
<td>• Southeast Asia</td>
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<tr>
<td>Domestic Factors/Institutions</td>
<td>• Closed economy</td>
<td>• Open economy (Export—Oriented Industrialization)</td>
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<td>• Dictatorship (The Junta)</td>
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<tr>
<td>Colonialism</td>
<td>Former colony of Great Britain → Independent in 1948</td>
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- In 1948, both Burma (Myanmar) and Thailand were wealthy Southeast Asian countries (Burma: the richest in the region).
- Today, Thailand’s per capita income is about six times that of Burma
# What Shaped Our World? Country Pairs (3): North Korea and South Korea

<table>
<thead>
<tr>
<th>Geographic Location</th>
<th>North Korea</th>
<th>South Korea</th>
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<tr>
<td>• Korean peninsula in Northeast Asia</td>
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<tr>
<th>Domestic Factors/Institutions</th>
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<th>South Korea</th>
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<tr>
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<td>• Open economy (Export—Oriented Industrialization)</td>
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<tr>
<td>• Communist dictatorship</td>
<td>• Dictatorship → Democracy</td>
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<tr>
<th>Colonialism</th>
<th>North Korea</th>
<th>South Korea</th>
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<tr>
<td>Former colony of Japan</td>
<td>→ Independent in 1948</td>
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- During the 1990s, North Korea fell into economic catastrophe while South Korea continued to develop.
While countries may have similar starting points and similar international conditions, their economic paths may be very different.

Domestic factors/institutions are very powerful forces which have a strong pull on national development.
Are Rich Countries Responsible for the Problems of the Developing World?

- Relationships between rich and poor nations can be cooperative.
  - All countries benefit from international trading, financial and monetary systems

- However, the interests of developed and developing countries may conflict.
Did Colonialism Hamper Development?

- Many instances of colonialism have helped stimulate growth in poor countries.
- Yet, most imperial powers used their colonies for their benefit at the expense of the colony itself.
- Interests of the colonies were generally secondary to that of the mother country.
Did Colonialism Hamper Development?

- The colonial world can be divided into two types:
  - Countries where European settlers could live easily and establish institutions → economic development of colonies
    - e.g., Australia, Canada
  - Countries were settlers were more likely to die of disease or other factors → exploitation of colonies
    - E.g., The Democratic Republic of Congo
- When the settlers’ interests coincided with those of the local population, colonialism was favorable.
Is the International Economy Biased Against LDCs?

- In the 1950s Raul Prebisch, an Argentine economist, argued that trade works against the interests of the LDCs.

- LDCs mainly sell primary products agricultural and raw materials, to very competitive markets.
  - The competitive nature of these markets forced the prices of these goods to decrease.

- On the other hand, manufactured goods were controlled by a few large oligopolistic firms, or firms that could control their markets.
  - These firms could keep prices high.

- The result was terms of trade (the relative movement of export and import prices):
  - Countries that specialized in primary products paid more for what they bought and got paid less for what they sold.

- Prebisch argued that industrial countries had an interest in preserving an international trade that was hurtful to the LDCs.
Is the International Economy Biased Against LDCs?

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Are International Institutions Biased Against LDCs?

- Some people believe that international political factors are responsible for worsening problems of development.
  - Wealthy countries protect their own interests at the expense of poor countries.

- LDCs often lose out in international interactions which are dominated by rich countries.
Are International Institutions Biased Against LDCs?

- U.S.: 31%
- European Union: 17%
- Asia: 19%
- Middle East: 12%
- Latin America: 8%
- Africa: 5%
- All Other Countries: 8%
Are International Institutions Biased Against LDCs?

- International trade agreements generally reflect the interests of rich countries.
  - LDCs constantly push the WTO for greater trade liberalization for farm products, but are repeatedly ignored

- International institutions can limit the growth and development of poor nations.
Before 1914, most developing regions focused on producing primary products and welcomed general economic openness.

But after 1914, ties to the developing world began to diminish.
Import-Substitution Industrialization (ISI)

- In the 1930s, many developing countries began encouraging industrial development.

**Import-substitution industrialization (ISI):**
- A set of policies that reduced imports and encouraged domestic manufacturing, often through trade barriers, subsidies to manufacturing, and state ownership of basic industries.
- Due to theories such as those of Prebisch, developing countries sought to move away from primary production toward industry.
- In Africa and Asia, decolonization was associated with replacing primary production with that of urban manufacturing.
Import-Substitution Industrialization (ISI)

- After 1945, most developing countries of Latin America and newly independent developing countries of Africa, Asia and the Caribbean began:
  - Stimulating domestic industrial development
  - Cutting ties with rest of the world
Import-Substitution Industrialization

- Most LDCs followed the broad outlines of import substitution:
  - Trade barriers to protect domestic manufacturers
  - Government incentives to draw investors into the modern industrial sector
  - Government provision of industrial services (such as electric power, finance and transport)

- By the 1970s, most of the larger developing countries following ISI were largely self-sufficient in manufactured products.

- However, many of the industries that ISI stimulated were largely inefficient and began to lose support.
Import-Substitution Industrialization

- Enthusiasm for import-substitution declined.
  - Selling to only a small, poor market reduced producers’ potential
  - Protected markets led to products of low quality
  - Developing countries sold very little to world markets
  - ISI unfairness towards agriculture hurt many farmers
Export-Oriented Industrialization (EOI)

- Countries in East Asia turned toward export-oriented industrialization (EOI) in the mid-1960s, encouraging manufacturers to produce for foreign consumers.

- Techniques such as tax breaks to exporters, low-cost loans and a weak currency helped make their products artificially cheap.

- E.g., South Korea exports: 
  $385 million (1970) \rightarrow $15 billion (1979)
The Turn Toward Globalization

- The debt crisis in the early 1980s was a fatal blow to ISI.
  - However, East Asian EOI economies were much better off

- During the 1990s, many LDCs turned toward globalization.
The Turn Toward Globalization

- **Washington Consensus:**
  - The transformation towards a general acceptance of market-oriented policies

- **Trade liberalization:**
  - The removal of barriers to imports and exports in an attempt to make national producers more competitive on world markets

- **Privatization:**
  - The selling off of many government enterprises to private investors who would presumably run them more efficiently

- **Fiscal and monetary policies** were executed to avoid deficits and high inflation.

- Openness to foreign investment and international capital flows more generally.
Attempts to Remedy the Bias of International Institutions

- Many LDC governments are attempting to counter the power imbalance in international institutions through the power of numbers.

- After WWII, many developing countries joined the Non-Aligned Movement and pledged to avoid alliances with the Soviet-led East and the American-led West.
Attempts to Remedy the Bias of International Institutions

- In 1964, a group was formed within the UN known as the **Group of 77**.
- The Group of 77 was composed of developing countries who attempted to use the power of numbers to shift the economic order in favor of the developing world.
Attempts to Remedy the Bias of International Institutions

- In the 1970s, developing countries in the UN fought for a New International Economic Order.

- This new economic order proposed:
  - Restricting the rights of foreign investors in developing countries
  - Revising trade agreements
  - Increasing the influence of LDC governments in international economic institutions

- Despite these efforts, little change occurred.
Attempts to Remedy the Bias of International Institutions

- However, LDCs were successful in strengthening their bargaining position through their control over natural resources.

- In 1973, the Organization of Petroleum Exporting Countries’ (OPEC) members doubled the price of oil by restricting their supply of oil to world markets.
Attempts to Remedy the Bias of International Institutions

- Imitating OPEC, many producers created commodity cartels:
  - Organizations of producers who cooperate to restrict the supply and raise the price of their products

- Despite these advances, LDCs are still largely constrained by international institutions.
Is Foreign Aid An Answer?

- Foreign aid is unlikely to play a large role in overcoming problems of underdevelopment.
  - Amounts of aid are small and unlikely to grow
  - Even increased levels of aid would not go very far in solving the basic problems of LDCs

- E.g., foreign aid is often misused by recipient governments.
Globalization and its Discontents

- Globalization has its problems and critics.
  - Integration into world markets creates losers as well as winners

- While today the poor make up a smaller proportion of LDCs, population growth has added about 100 million people to the ranks of the poor.
Conclusion: Toward Global Development

- How do we improve the living standard of the billions of people in the developing world?

- Finding an answer requires understanding how and why countries have failed or succeeded in developing.
International institutions generally favor developed countries, reflecting inherent power relations among nations.
- The IMF, the World Bank and the WTO all have a bias toward rich nations.

This bias may even be formal.
- For example, in the IMF votes are weighted by economic size.

Yet, common interests exist.
- The IMF and the World Bank have made efforts to reform and address issues raised by LDCs.

Domestic forces are probably the most important factor affecting economic development and growth.
Addressing Domestic Factors

- Domestic interests may hinder economic progress.
  - However, these interests are only successful in slowing growth if they are able to dominate society and politics

- Political institutions play a large role in determining whether a country can overcome obstacles to development.

- Domestic features are key to understanding developmental problems.
  - Many countries have made much progress in economic development

- Development is often held back by domestic interests, interactions or institutions.