

A Short History of Development Thinking and Policy

Background

Before 1800 or even 1850, shipping goods was expensive and most markets were local. There were theories of trade that basically said, “Exports were good and imports were bad.” This was called Mercantilism and the point was to gather gold and silver for the king or state, which could then wage war or build palaces. It was not really about making the country richer, much less the people.

Adam Smith, arguably the first modern political economist, argued against Mercantilism. He wanted specialization and free trade and competition rather than monopoly. He argued that this would cause nations to “thrive” – meaning to grow. He said that a nation needed only peace, easy taxes, and a tolerable administration of justice to grow, though he also endorsed building roads, educating people, and awarding patents for inventions.

Britain was the first nation to extensively use water and coal power in industry, especially textiles. Because they became low-cost producers, they supported free trade, or trade with low tariffs. But their colonies were structured to provide raw materials and buy British manufactures. (The UK finally allowed imports of cheap foreign grain – helping the workers and their employers but hurting the landlords.) The US, when it got its independence, soon adopted tariffs. These were for government revenue but also to protect the “infant industry” in the US that was just getting started. Since the US had a rapidly growing internal market and a lot of raw materials, it was able to operate with high tariffs. Steamboats and railroads knit the US economy together, but the export of cotton and grain to Europe was also quite important. The US grew, mainly with high tariffs and exports of raw materials in the 1800’s.

As Germany unified and became an industrial power in the later 1800’s and early 1900’s, the UK switched more to a “Commonwealth System” which excluded or taxed competitive products produced outside of the UK. In spite of this, up to World War I, there were growing levels of trade. This was partly due to lower shipping costs and partly due to policy which recognized that trade was beneficial. Most economists equated trade and development, though this applied more to independent countries with reasonable freedom of action and human capital. Colonies and poor countries did not grow so fast.

The WW I to WW II Period

Normal trade was disrupted during World War I and set back again during the Great Depression of the 1930’s. Most countries then wanted to export for employment reasons, but not import. This was collectively impossible, and the result of rising tariffs and competitive devaluations resulted in shrinking trade and output. This hit smaller countries particularly hard, since small countries tend to benefit more from trade than big ones. (Imagine if each province in Vietnam was a country and could not trade!) The trade was disrupted again during WW II. To many politicians, trade just seemed too risky, and some economists argued that import substitution (IS) was a good way to grow.¹ This meant that if a nation imported something, it would put a tariff on it and try to produce it alone. This might work well for some products that are not too hard to make and do not have large economies of scale. But others – cars,

¹¹ There was also a belief that raw material exports were doomed to have declining terms of trade and were best taxed to subsidize industrialization. This included agriculture, which had most of the workforce. In practice, this led to “urban bias” which rewarded wealthy urban elites and a small urban formal workforce.

airplanes, computer chips, etc. – are VERY hard to make for most small countries. But given the upheavals from wars and depression, not many countries wanted to specialize in a few things they were good at and trade for other things.

The 1945-75 Period

The major development ideas (or fads) during this period involved central planning, import substitution, and taxing agriculture to promote industry. Central planning was not just something done by the Soviet Union. It had also been used by both sides during WW II, and for many nations rationing after the war was necessary. It seemed rational to allocate scarce resources to where they were most needed. (“Need” is a political or social term, while “demand” is an economic term. The groups who had more influence got better allocations from the planners.) Meanwhile, IS allowed governments not just to raise tariffs, but also to allocate quotas (permits to allow imports). This was a good way to reward friends or take bribes. The companies that got quotas or were monopolists in their industry in smaller countries faced little market pressure to cut costs or improve products. This made it hard to export, except for raw materials. But since agriculture was being taxed, raw materials exports – outside of mining – did not grow very fast. The result was that most IS countries grew well for a while but stalled or had economic crises when their raw material export prices fell, or import prices rose. Many IS countries imported oil and oil prices rose in the 1970’s.

There were a small number of countries in this period that avoided IS and instead tried to export. Taiwan, South Korea, Hong Kong, and Singapore were in this group. They all lacked raw materials, had high levels of human capital, and a fear of Communism. Targeting foreign markets, often following in the footsteps of Japan, allowed them to use their labor and skills to export and earn foreign exchange for imports of both consumer and capital goods. All of these countries grew quickly and sustained their GDP growth until they reached European levels of per capita income – or more. They were less impacted by high oil prices because they had learned to export different products and were able to adjust quickly.

The 1975-2008 Period

As the shortcomings of IS became clear, more nations began to emphasize exports. Because exports, except for raw materials, often require agile companies with knowledge of markets, this movement also tended to undercut central planning. (In any case, the USSR was slowing economically by the 1980’s and finally dissolved.) There were also global food shortages in the 1970’s and more emphasis was placed on rural development. With the collapse of the Soviet Union, a kind of free-market approach called the “Washington Consensus” emerged. This emphasized the role of competitive private markets with flexible prices, low inflation and balanced budgets. Firms were supposed to maximize profits. During this period, trade grew more rapidly than global output and a lot of manufacturing moved to developing countries – often assisted by large flows of foreign direct investment.

While much of Asia grew quickly, with the significant shock of the “Asian Financial Crisis” in the late 1990’s, other regions had more mixed experiences. Latin America suffered a “lost decade” in the 1980’s, as their huge debts incurred during the IS period, took time to negotiate. Africa suffered from wars and droughts, as well as some governments which were unusually corrupt or violent. Parts of the Soviet Union or Eastern Europe had stagnated up to 1990, and then took time to re-orient their economies. (See appendix.) Much of the very rapid growth came from shifting workers from low to high productivity sectors – a reason there is a limit to the period of very rapid growth for any nation. Of course, growing productivity in all sectors was also important, but only part of the growth story.

Dutch Disease – The Impact of a Mineral Boom

The Middle East, often reliant on oil, suffered (as did some other resource rich economies) from the “Dutch Disease”. This, first observed in Holland when they developed a large gas field and exported the gas, refers to the impact of a large rise in mineral revenues on the broader economy. If you divide an economy into a booming sector (such as oil or gas), a non-booming tradeable sector, and a non-tradeable sector, there are flows of labor from the lagging tradeable sector to the booming sector and to the non-tradeable sector – the revenues from oil or gas fund service spending. The real exchange rate also appreciated, boosting imports and discouraging non-mineral exports. But, in practice, this often meant that manufacturing and even agriculture suffered. When or if the booming sector faltered, there was not much capacity in the lagging tradeable sector to balance the shock of (say) lower oil prices. And with lower mineral revenues, spending on services fell. The result was unstable and narrowly based economies that failed to sustain growth. Nigeria is often used as an example of the Dutch Disease, but Mexico, and many Middle Eastern countries had symptoms. Indonesia largely avoided this by investing in rural development, maintaining a stable real exchange rate, and keeping its debt low.

The bottom line seems to be that manufactured exports provide the potential for more “linkages” to other inputs or sectors than raw materials, as well as typically using more labor. The learning and technical advances that spread throughout the economy also seem larger, as many minerals are essentially “enclaves” with limited contact to other domestic sectors. This does not mean that raw material exports are bad or without value to development, but their benefits require better policy to be realized. The other point is that large “rents” from minerals often lead to bitter political struggles over them, while manufactured exports reward efficiency and learning. This element of political economy may be at the heart of the observed slower growth in many mineral-rich economies.

Globalization – Upsides and Downsides

Overall, the period of growing globalization was a good one for the developing countries and the global economy. Billions of people escaped poverty and there was a rise of a global middle class. Trade barriers dropped and trade grew rapidly, helped by the falling cost of shipping and easier electronic communication which built on fiber optic cables, computer chips, and the Internet. Education grew and health improved – although the fall in infectious disease deaths was offset to some degree by a rise in heart disease, cancer, and stroke. This “rich country diseases” were associated with diets that had more sugar and fat -and excessive intakes – as well as smoking and a lack of exercise. Air pollution grew in many countries, usually from coal burning and industrial and auto emissions, and this also caused millions of deaths each year.²

However, there were significant problems with the development model of this period. Markets are social institutions and need both support and correction. They may produce and did produce in this period unwanted side-effects such as significant inequality and pollution. Climate change was largely treated as a second-tier issue with little global action to reduce emissions, which grew steadily.³ Monopolies and

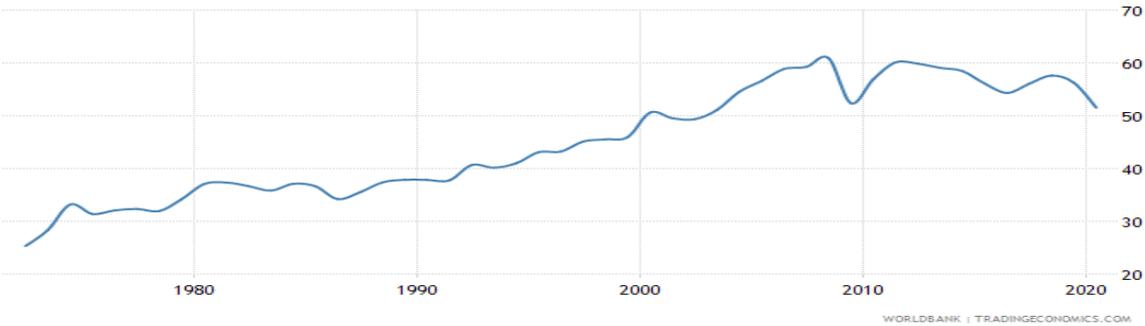
² Estimates are there are seven million annual excess deaths per year from both outdoor and indoor air pollution <https://ourworldindata.org/data-review-air-pollution-deaths> Of the total, 4.2 million are from outdoor pollution.

³ Global annual emissions increased, with about 80% of the net increase coming from China, India and ASEAN. The US and EU tended to have stable or declining emissions, but from a high per capita level.

industrial concentration grew, and with it, real wages of many rich-country workers stagnated. This led to excessive and risky lending, especially for real estate, and to the global financial crisis. (The risky mortgage debt was repackaged and widely bought, appearing to be safe.) Financial institutions took speculative positions with limited capital, risking systemic collapse of banks and other institutions. When these problems came to a head in 2007-08, central banks responded by bailing out the banks with massive loans and printing of money. This led to widespread anger against elites and set the stage for populist politicians who rejected free trade and migration. (See graph of global trade to global GDP below). Migration came to be treated as a domestic rich-country political issue, when in fact it reflected growing pressures on many workers in developing countries fleeing climate pressures and domestic instability. Migrants rose from 153 million in 1990 to 280 million in 2020, or 3.5% of world population.

The other aspect of globalization was the hyper-specialization of production, leading to complicated supply chains which, while efficient, were vulnerable to disruptions such as Covid, wars, or geopolitical tensions. This specialization tended to make national, integrated industrial strategies less competitive. Rather than make a car or smart phone entirely in one country, it became more efficient to source parts from many countries. The degree of value added in each country determined relative incomes.

Global Trade to Global GDP, 1976-2021



Current Development Trends

The combination of Covid, conflict in Ukraine, and climate change are providing shocks to the world economy. There is talk of moving production of “essential” or “strategic” goods back to some consuming nations, or at least to friendly neighbors.⁴ The rise of China, seen as using economic pressure as a routine instrument of national policy, has made many nations shift production and investment away from China to other countries.⁵ Russia has used its oil and gas exports to pressure European countries to allow its expansion into its “near abroad” but the invasion of Ukraine seems to have gone too far and created a backlash. China with its “dual circulation” model is attempting to be much more self-sufficient, aside from

⁴ Janet Yellen, the Treasury Secretary, talked about “friend-shoring” in a recent speech. This would apply to goods that were systemically important. If implemented, this would tend to divide countries into those more or less allied to China and those the US considered a reliable production site and export supplier.

⁵ In fairness, economic pressure is often used by others though it has tended to be more limited and bound to some degree by rules. On the other hand, the response of most rich countries to the invasion of Ukraine has been unprecedented in its economic isolation of Russia.

raw materials. But if manufactured exports are a stagnant or declining share of global output, what is a reasonable approach to development for a low or middle-income country?

It is hard to incorporate the lessons of the past few years into a long-term policy. Climate change has been a factor in leading Indonesia, for example, to limit its palm oil exports – a staple used widely by many nations. Since it is the largest producer, this would suggest trying to produce more oil seeds domestically, even if the costs would be higher. But that might mean less cereal production, and the Ukraine conflict has led to less production and exports of grain, and rising food prices. It would be wasteful to incur permanently higher food prices for occasional shocks, but the options of strategic reserves of vegetable oil or long-term contracts are not complete insurance.

While trade may not be growing relative to GDP globally, if China's trade/GDP ratio declines, that of some others might increase. But to benefit fully, the nations exporting instead of China need to deepen their industrial structure and add more value to their exports, rather than merely assembling imported pieces. Regional cooperation, such as within ASEAN, would help to realize economies of scale.⁶ Upgrading education and training, increasing research and development, and creating an environment where ideas can become products and successful companies are sources of new growth.

As population growth slows and the work force ages, there will be difficult questions of how to finance retirement – if indeed that is possible. Perhaps, older workers will have to continue to work if pensions or social security are meager. Growing old while still poor will pose challenges, especially for those developing countries that have fertility rates below 2.1, the replacement level. By 2025, only Africa and Oceania (small Pacific Island populations) will have total fertility rates above 2.1 according to UN estimates.⁷ Productivity in those regions is low, so most inter-generational transfers will be domestic, from a shrinking workforce to growing elderly populations.

Aging and shrinking populations will also provide challenges for economic growth. Usually, younger workers provide new technical skills and capacities. Perhaps robots will take over some jobs and allow the shrinking number of young workers to be more productive. Or better communications will “stretch” scarce skills, such as with telemedicine augmented by artificial intelligence. But there are really no examples of rapidly growing economies with shrinking and aging populations. Of course, rapid growth itself may become obsolete as climate and other pollution concerns limit many types of growth. If that is true, then migration may be the only solution to raising incomes, as moving workers from low to high productivity sectors and regions will have to be international rather than national.

In summary, development is a different game now than it was some decades ago with different opportunities and constraints. Increasing skill acquisition, technical capacity, and agility to respond to shocks will be needed for low- or middle-income economies that hope to continue rapid growth, though maintaining access to both US/EU/Japan and Chinese markets may prove to be tricky. Maintaining openness to flows of knowledge, capital, and trade will be key to raising productivity.

⁶ While ASEAN has a free trade area, there are many exceptions to traded goods. The share of intra-ASEAN trade has not grown since 2000 and fell from 2010 to 2020. Most trade is with rich countries or China.

⁷ <https://ourworldindata.org/grapher/total-fertility-rate-by-world-region-including-un-projections-through-2100>

Appendix: Per Capita GDP Growth at Constant Market Prices (World Bank)

Region	1960	2018	1960–1970 annual growth	1970–1980 annual growth	1980–1990 annual growth	1990–2000 annual growth	2000–2010 annual growth	2010–2018 annual growth	1960–2018 Total Growth
World	3746	10857	3.41%	1.96%	1.34%	1.32%	1.54%	1.63%	189.82%
Eurozone	10733	40953	4.95%	2.92%	2.12%	1.94%	0.74%	1.09%	281.57%
North America	17453	54261	3.21%	2.17%	2.27%	2.14%	0.73%	1.45%	210.89%
East Asia and the Pacific	1283	10262	5.57%	2.9%	3.63%	2.49%	3.67%	3.70%	699.97%
South Asia	332	1888	2%	0.67%	3.07%	3.19%	5.26%	5.21%	468.63%
Sub- Saharan Africa	1115	1659	2.13%	0.94%	-1.56%	-0.64%	2.86%	0.63%	48.84%
Latin America and the Caribbean	3708	9141	2.8%	3.56%	-0.58%	1.43%	1.94%	0.23%	146.53%