international master **Microfinance** for entrepreneurship

6th edition Students Essay

Discussing Easterly's *The elusive quest for growth*

International Master in Microfinance for Entrepreneurship

Universidad Autónoma de Madrid

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Andrii Tiurenkov

Main factors of economic growth and development

Economists all around the globe are permanently looking for answers trying to solve different economic problems, but the question of economic growth factors is probably one among the most influential since the 50's of twentieth century. In addition, to find the economic growth factors within the framework of economic development (Ray, 2007: 1) is not only highly important and significant from the academic point of view, but also practicable and applicable to solve a broad range of economic issues such as poverty eradication and inequality reduction, unemployment rate decrease and sustainable development retention.

It is probably because the economic development might mean progress towards ethically defined goal or what is more, the development might be viewed in relation to positive movements in real income per capita (Lord Robbins, 1970: 4). Following that, an increase in income per capita led to the decrease in the number of people, who lives below the poverty line (Easterly, 2001: 14).

Thus, the ethically defined goal of, for example, poverty reduction (as well as many others) might be achieved by economic development with the potential of sustainable economic growth.

As the goal of poverty reduction is considered within this essay as solvable by the economic growth and William Easterly, *The Elusive Quest for Growth* (2001: 8), believes that GDP growth per capita translates into rising incomes for the poorest of the poor, it would be appropriately to discover and identify the main economic growth factors.

Although, there is no general definition of economic growth and it is very common that economic growth is used interchangeably with the economic development, in this essay by saying economic growth we understand the increase in a country's production or income per capita. Next, we refer economic development to economic growth, which is accompanied with changes such as improvement in the material well-being of the poorer half of the population, a decline in agriculture's share and an increase in service's and industry's share of GNP, an increase in the education and skills of the labor force, and substantial technical advances originating within the country (Nafziger, 2012: 14).

In order to find the answer to the main question of this essay – what are the main factors of economic growth and development, we might go as far as to deep inside the economic theory or political economy. We may look at the processes of Ancient and Medieval Economic growth or analyze the Capitalism and modern western economic development. Or, alternatively, we might attempt to gain an understanding of the either Japanese or Korean-Taiwanese development models. Another option – is to

attentively look for the growth in the last 100 to 150 years and to see that, for example, for the range of 1870-1998, the USA - is the economic leader in the GDP per capita most of the time since twentieth century (Nafziger, 2012: 71) and at the same time is among the top-ten in GNP per capita growth with 2 percent annually (Maddison, 2001: 186, 196, 216, 256).

In order to understand how the USA managed to achieve high rates of growth it is necessary to find out what exact actions were done by the country. Yet Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical perspective* (2002), mentioned that the USA as well other rich countries used the ladder of state intervention and protection in their own industrialization. E. Wayne Nafziger, *Economic Development* (2012: 71), says that in the nineteenth century the USA employed universal free public education, public aid for agricultural research and extension, subsidies for the purchase of frontier homestead farms and high tariffs for manufacturing.

Those points make some tips for better understanding the possible factors of economic development that lead to economic growth. As it can be seen – the push towards the education, fostering the research as well as the financial aid to investment for self-employed entrepreneurs are mentioned among the valuable factors of growth. The output from these factors was strengthened by the national economy industrialization protectionism policy. Hence, we may assume that the US was purposely increasing its absolute advantage in technology, which was vital for the industrialization and what is more —considerably contributed to make US companies internationally significant.

There is another very illustrative example, which is mentioned by E. Wayne Nafziger, *Economic Development* (2012: 81) —the contrast between Thailand and Philippines, both with a population of forty-one million and an GNP per capita of $310 to $330 in 1968 (in 1968 U.S. dollars) (World Bank 1970d). However, there was a considerable discrepancy between the income distribution in the two countries during the late 1960s and 1970s: the bottom 20 percent of Thailand population was twice wealthy than the analogous bottom 20 percent in Philippines. Furthermore, from 1968-2000, the annual real growth per capita was 3.63 percent for Thailand (more than threefold increase for the period) compared with 1.67 percent for the Philippines (less than a twofold increase) (World Bank 1994h:210-11; Barro 2001:31). Among the reasons are —Thai banks were more likely to be privately owned and in credit policies Thai government targeted small and medium scale agriculture and industry enterprises, when in the Philippines the lending were more oriented toward large enterprises. Moreover, if to look for the poor 20 percent we will find that Thailand, unlike Philippines, has superior progress with electrification of rural areas (Nafziger, 2012: 81).

Having this example in mind we can thus assume that fostering the small and medium enterprises as well as implementing technological products for the households and those self-employed people — leads to acquisition of absolute advantage among the peers.

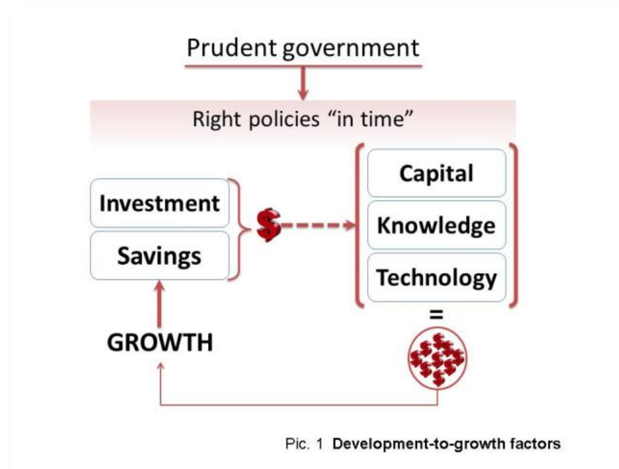
Technological progress itself, which may result in savings of either labor or capital (i.e., higher levels of output can be achieved with the same quantity of labor or capital inputs), is now considered by many economists as the most important source of economic growth (Todaro and Smiths, 2012: 143). If to continue analysis of the example, which is mentioned in Todaro and Smiths, *Economic Development* (2012: 143) we can find that for the developing economies or capital-scarce economies capital-saving technological progress is what is needed most since such a progress results in more efficient (lower-cost) labor intensive method of production, which in turns results in decrease of the amount of investment needed.

Up to now, within this essay we brainstormed a number of factors of economic development that work as economic growth accelerators. These are economic policies for capacity building, especially for entrepreneurship development, investment in human resources or in the other words - increase in the number of skilled and educated labor force and strategy for technological development (Robock and Simmons, 1989: 241). However, despite this conclusion is not derived empirically and the most important factors in this list are considered only subjectively, there are two factors, probably “the prime movers”, which must undoubtedly be taken into account. These are a capital and a prudent government.

Capital continues to be recognized as a crucial bottleneck (Robock and Simmons, 1989: 241). Capital is meant here as capital goods, which consist of the great variety of durable tangible goods that are used to make other goods. They include structures like factories and houses, equipment like computers and machine tools, and inventories of finished goods and goods-in-process (Samuelson and Nordhause, 1989: 855-856).

The prudent government, on the other hand, is able to set right policies at the right time. Such policies should include vaccines against high inflation, high black market premiums, negative real interest rates, high budget deficits and restrictions on free trade. Proper and prudent government has to implement policies to foster entrepreneurship and property rights, improve public services and to establish democracy, to protect freedom and individual rights.

With the aim to better understand the main conclusion of this essay and to explain the interrelationships between the factors of growth, which are described above we propose to have look into the Development-to-growth factors (pic.1).



Pic. 1 **Development-to-growth factors**

✉ master.microfinance@uam.es ∗ www.mastermicrofinance.com ∗ ☎ (+34) 914 974 216

Brooke Cain

Institutions are Fundamental.An Examination of the Factors of Economic Development

Introduction

The factors that influence economic development—economic factors, geographic and climate factors, post-colonial dependency relationships, social and political factors, and cultural or superstructural factors, each play a role in development. Further, all factors are interrelated, as the characteristics of one factor work to influence the characteristics of all other factors. Because of this interrelatedness, it can be difficult to determine which factor most influences the development of all countries.

Through closer examination into the research on development, my conclusion is that cultural and superstructural factors are the most fundamental to the development process. Not only do cultural and superstructural factors, namely institutions, have the ability to undermine or support the development of a nation, they also play a vital role in how the other development factors will work to influence that nation's development.

Explanation

North (1990) explains that institutions are constraints devised by humans to shape human interactions and structure incentives. Additionally, Todaro et al. say that development is represented as multidimensional change within an entire social system that moves it away from an unsatisfactory condition of life toward a better situation (Todaro et al. 2012). Through an examination of the role that institutions play in the other factors of development I hope to show that institutions are the basic elements of each factor that influence a nation's economic development. The only way to change an entire social system is through its institutions.

In looking at the economic factor, North notes that institutions structure incentives in political, social and economic exchange (North 1990). Further, these institutions can have varied results, some leading to growth and development and others having the opposite effect (North 1990).This highlights the vital role that institutions play in influencing the economic factors of development.

Additionally, Easterly (2001) explains how institutional failures, like corruption and over-regulation, undermine a county's ability to grow economically. The result being

that even those nations with access to plenty of public funds might still fail to provide essential public services when institutions fail, as was the case in Nigeria with its $280 million in government oil revenues (Easterly 2001).

This idea is also supported by Collier's (2007) examination of poverty traps that plague poor countries. Why is an abundance of natural resources a trap in sub-Saharan Africa, but not in Sweden? Collier argues that the main and pervasive reason that natural resources are a trap is the lack of good governance or essentially it is a product of institutional failure (Collier 2007).

When looking at the geographic and climate factors of development, at first it might be difficult to see how institutions could play a role here. Engerman and Sokolof argue that the geographic location of former colonies of the New World played a role in their future economic growth and development, but once again the most fundamental aspect of this argument points to institutions (Engerman and Sokolof 1997).

They illustrate how former colonies that had climates and soil that were well suited for high-value crops, including the southern states of the United States, were set up as plantations to more-efficiently produce these crops. This set up led to an unequal distribution of wealth and political power. These inequalities were then perpetuated through policy with consequences that remain today (Engerman and Sokolof 1997).

Alternately, because the climate was different in the northern colonies, the arrangement was much different. Engerman and Sokolof (1997) point out that without the need for economies of scale to produce the high-value crops, the northern colonies were set up as small family farms. This led to a more equal distribution of wealth which fostered more democratic institutions, the effects of which are seen today in more economic development in these regions (Engerman and Sokolof 1997).

In looking at the post-colonial dependency factor, Todaro et al. (2012) highlight the fact that institutions are at the heart of this issue. Colonial powers often favored extraction institutions rather than encouraging productive effort, so the "rules of the game" determined whether the legal and other institutions would encourage investment or facilitate exploitation (Todaro et al. 2012). The long-term effects of these colonial era institutional frameworks continue to hinder the economic development of many countries today.

Turning to social and political factors, Easterly (2001) points out that the return on educational investment in developing countries has been poor. He believes that institutions in part are to blame (Easterly 2001). Easterly (2001) outlines how institutional failures, such as extensive government intervention or high black market premiums, eliminate the development advantage expected from a growth in education. He goes on to point out that education only supports growth when incentives for growth rather than redistribution exist (Easterly 2001).

Additionally, Easterly (2001) makes the bold statement that governments can kill growth, but also notes that good governance and policies can help the growth process. He warns that institutional failures at many levels can severely undermine the ability of a government to encourage growth, and highlights the importance of institutional reform (Easterly 2001).

Because institutions are the building blocks of government, it is difficult to discern where institutions end and governments begin. Banerjee and Duflo (2011) provide a useful way to look at the issue. They point out that traditionally, when we have talked about institutions, we have been referring to the overarching institutions that make up the government, which they call “INSTITUTIONS” (Banerjee and Duflo 2011). They believe that this definition is missing the fact the INSTITUTIONS are made up of many smaller local institutions that are on the ground doing the work (Banerjee and Duflo 2011). Further, Banjeree and Duflo (2011) state that many institutional failures, such as corruption, can begin to be fixed from the bottom up with slight improvements in transparency, which gives people a way to demand more accountability.

Conclusion

It remains clear that all factors of development work together to either encourage or discourage development and a clear delineation of where one factor ends and another starts does not exist. While, unfortunately, there is no silver bullet to solve the problems of the world’s poorest countries, I am encouraged by Banerjee and Duflo’s (2011) idea of the power of small change and that work within institutions at the most local levels can make a difference in the lives of the poor. This idea puts some of the power of change in the hands of those most affected by institutional failures, and makes me believe even stronger that providing microloans to families in some of the world’s poorest countries can make a difference.

Ding Han

Unqualified Government. The simplest way to explain the problems of the poor nations

Introduction:

In the last three decades, we saw some developing countries are able to get rid of the poverty, maintaining a constant high growth rate, like the case of East Asia. By contrast, other countries in Africa, they performed well in the early years of its independence, but failed its performance tests post 1970s. They seem to be cursed and stuck in a vicious circle, low growth, civil war, GDP decline etc. Why? Among all the different factors which affect the economic growth and help the poor people to escape the poverty, the researcher found that a qualified government and good policies play a crucial part.

The governments failed in Social security and financial policies

Although all the government functions are important, like military defense, environmental protection, on this paper, the researcher focused only on the economic affairs in this paper.

According to the corruption perception index 2013(transparence international, 2013), the most corrupt countries in the world are Somalia, North Korea and Afghanistan. The World Bank had difficulty to collect the three countries' data, but their economic situation is extremely terrible through some reports. These countries are haunted by wars, pirates, terrorist attack, and bad harvest, the last one leads to famine. The governments (except North Korea) are unable to establish a social order, they cannot provide a security environment for the investment or protect individual's wealth. Foreign investment will give a bad expectation to these countries, therefore, the poorest people get excluded from the international financial system, and they have little chance to climb out of poverty to prosperity.

The World Bank and IMF pursued an ambitious hope of achieving "adjustment with growth" through intensive involvement with poor recipients. The operation was a success for everyone except the patient. There was much lending, little adjustment, and little growth in the 1980s and 1990s (William.E, 2002). The answer comes from what those countries were doing in response to this financing. International donors gave them the loan, but something happened during the transition (Williams.E, 2002:105): the money was diverted to any other purpose, the Presidents or ministers didn't keep their promises to make political or economic reform, in the end, the

leaders of these countries get lazy, and they took the poverty as hostage in order to win more loans. If the foreign donors want to create a positive incentive to the economic growth in the poor countries, the first obstacle to overcome is the recipients' bad governance.

Many poor countries haven't established a sound and smooth financial systems, they cannot prevent the high inflation or international financial crisis, which destroy their vulnerable economy. On the other hand, they are highly protectionist, in order to keep their foreign exchange reserve, the governments don't allow their citizens or small companies to buy U.S. Dollar or Euro, and a black market has been created. Usually, the rate of change in the black market is 50% higher than the official rate (Namibia finance, 2004). The consequences were: first of all, people who have the background can purchase the U.S. Dollar in the official way and resell it on the black market. Secondly, for those import-export companies, they don't have access to get enough foreign exchange. The last but not the least: these countries will become less attractive for the foreign investors, because the investors loss 30-50% of profits when they send the money back through black market.

Bad Policies on Education, Corruption

One of the most important development resources the world has been ignoring is the intelligence of people in the bottom billion. And yet they never have chance to contribute to the development of their own countries. They know what is the poverty and the solutions to get rich better than most of us. But, unfortunately, in Africa, children may have only a few years of schooling and that is continually interrupted.

Even in the countries where a public education system has been founded, the quality of education is never as good as we expected: students will goof off in the classroom or sometimes not show up at all, parents will often pull their children away to work on the farm (William.E, 2002:82-84), there is supposed to be free food at school—the government program, but there isn't. The teachers have a legitimate excuse to steal the money: the corruption, low salaries, etc. So they do nothing in class until the inspection (Aravinda.A, 2008). When a student finally get graduated from the college, he is more likely to migrate to USA or other richer countries, because there is no incentive to hold him on his homeland. The wages are lower, and facing a corrupt government they have little opportunity to apply their knowledge. With this brain drain phenomenon, the poor countries are losing most of their skilled workforce.

A good government does not steal the fruit of worker's labors, but instead of providing hope for the poor people. Nevertheless, the poor nations' governments are making the people's situation worse. African leaders extract billions of dollars every year from their economically strapped countries, the corruption is everywhere, from up and down, it has negative effects on the level of production, consumption, private investment and employment (Michael P. Todaro, 2012:524). Poor people frequently

complained that the services they need are not available (Deepa Narayan, 2000:93). They tend to trust an international agencies rather than their own government.

Conclusion:

In recent years, there are several new discoveries in some poor countries, Uganda has discovered oil, Mali has discovered oil and uranium, Angola is becoming the second petrol producer in Africa, the GDP growth rate is around 5% per year(World Bank,2013), but the question is whether the growth will persist. And with the bad governance historically, the growth will not last for a long term.

What the poor countries should do? First of all, stabilize the political situation and social order, they do have an instant democracy, like president competition, but there is a lack of execution of democracy. Plenty of electoral competitions have been manipulated, civil wars or coup d'état break out frequently.

Secondly, they should abandon the protectionism policies, establish a sound financial system, so the precious resourced will not be wasted in the black market, the country will become more attractive for the foreign investment.

In order to achieve those two goals, human resource is an essential ingredient. Therefore, government need to improve the education quality, supervise the teachers, and make new policies to reduce the brain drain.

The leaders of the poor nations must fight against corruption as well as administrative inefficiency. They need to elevate their governance level, create a business climate which is favorable to foreign direct investments. They also should subsidize the technological research because it brings benefits to the whole economy (William.E, 2006:186).

Julia Marín Morales

The elusive variable

The aim of this essay is to identify the central variable affecting the development process. Ambitious and controversial as this purpose might sound, it is worth debating and its discovery has been considered as "one of humankind's great intellectual triumphs" (Easterly, 2001:11). Literature over this topic is voluminous, and I do not have a preconceived hypothesis, so my methodology will be based on researching the most outstanding theories around this topic in the search of a variable that satisfies the following requirements: 1) this variable should create multidimensional change in the different spheres of the whole social system and 2) the change produced should be sustainable in the long-term. I do not attempt to mention every possible cause of development and discuss its its feasibility, since most likely the list will be incomplete. I used the dichotomy between the first and last chapter in Easterly (2011) as a guide for my framework.

The first problem in this search for a variable arises with the mere definition of development because, as Todaro argues, development usually "means different things to different people" (Todaro, 2009:14). A more traditional view of the term was based in pure economic performance, so GNI and GDP per capita were considered valuable indicators in the development field. But the seventies brought high rates of growth with almost no improvement in poverty reduction, employment rates and equality indicators, so there was a call for a more multidimensional definition of the term. Development was understood as s series of "major changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, the reduction of inequality, and the eradication of poverty" (Todaro, 2009:16).

However, this shift into a more comprehensive definition has not been categorical, and the idea that economic growth by itself provides the resources to permit "sustained improvements in human development" to the whole population remained among various economists (Ranis, 2000: 197). In other cases, the change was belated and subtle. That is the case of David Dollar and Aart Kraay, whose "Growth is good for the poor" had a great influence upon the World Bank development strategy during the nineties (Dollar and Kraay, 1991). The title gives us a hint about what they considered to be the main variable causing development, but they also include data showing how "good rule of law, openness to international trade, and developed financial markets—have little systematic effect on the share of income that accrues to the bottom quintile" (1991:9). This study has been revisited in 2002 and 2013, and new data shows that only over three-quarters of the improvement in the incomes of the poorest 40% is attributable to growth; even though the influence has been reduced, economic growth still remains as the winning variable so, why bother to keep searching?

The dichotomy between the first and the last chapter in Easterly (2001) (also a former World Bank man) serves as a very illustrative metaphor for our research. "The Elusive Quest for Growth" starts by setting out the correlation between the alleviation of poverty and economic growth, based on the papers produced by his aforementioned colleagues at the World Bank, where "culture or institutions could not explain the simultaneous change in income and change in infant mortality", and therefore "the main variable affecting the development process in a country will be growth and GDP" (2001:9). Throughout the following chapters, he draws some criticism over the tools which have been used by International Development Agencies to help in the development process. From the Harold-Domar financing gap model (Chapter 2), to programs of debt forgiveness, the author points out the ways in which different variables chose by these International Financing Agencies failed to achieve sustainable development in poor countries; criticising not only the failure but the persistence of their strategies; "that didn't work, so lets try again" (Easterly, 2001: 36)

Even though the tone in Easterly (2001) is quite pessimistic, often leaning towards describing mistakes instead of solutions, the final chapters of the book break away from the statements made in the introduction and offer alternative variables. Opportunity for economic development is found when "increasing returns allow investment in human capital"(2001:145) thus providing a way out of the poverty trap. To achieve that goal, the different players should coordinate investments, but such coordination is not doable without a centralised power for which the market is no viable substitute. Government policy is therefore understood by Easterly as the variable needed to enable an investment in both human capital and technology for the future. His theory does not come without warning: Governments can also kill growth and "too long we have ignored corruption on the quest for growth" (2001:252).

Easterly does create a compelling framework based on government control over incentives. This idea clearly resonates with North and Thomas (1973: 2), when they identify that factors such as innovation, economies of scale, education, capital accumulation, etc. are not causes of growth; they are growth. Their conceptual framework enlightens the debate over what development implies, suggesting that greater levels of total factor productivity, human capital and physical capital are not sources of prosperity but prosperity itself.

In their "causal chain", those factors are directly influenced by the role of institutions. Years later, North alone made his case for the importance of institutions in economic performance in a separate book (North, 1990). The value of these institutions is to serve as guidelines for human interaction and reduce uncertainty by providing a structure to our everyday life. To build a theory of institutions on the foundation of individual choices is a step towards reconciling the difference between economies.

North does provide this theory of institutions, but systematic evidence on whether and how institutions influence development is missing in his approach. Acemoglu, Johnson and Robinson (2001) do provide that empirical evidence while using the pragmatic structure of North and Thomas. They show how political and economic

institutions underlie economic success, and validate their idea with numerous historical examples worldwide. Countries with good institutions, which they describe as "inclusive", forged a society which created incentives, rewarded innovation, and allowed everyone to participate in economic opportunities. Moreover, the development achieved through these institutions was sustainable due to the creation of centralised and pluralistic political institutions, capable of making the government accountable for their actions (Acemoglu et al., 2012: 103).

Jared Diamond, a well-known advocate of the geographic origins of developed countries' dominance in the modern world (Diamond, 1997), points out two main determinants for growth which Why Nations Fail (2012) did not take into account: tropical diseases and tropical agricultural productivity (Diamond, 2012). He argues that geographical latitude acting independently of institutions is an important geographic factor affecting power, prosperity, and poverty. Geography matters, but even one of its most arduous advocates recognises that institutions "perhaps provide 50 percent of the explanation for national differences in prosperity".

An interesting counterpoint to this criticism is present in the analysis developed by Rodrik (Rodrik et al., 2012). They measure the independent contribution to cross-national variation in income levels of what they consider the three main "strands of thought" in the development process: geography, integration and institutions. Institutions, measured with property rights and the rule of law, are always statistically significant, while trade and geography indicators often enter some kind of income regression with a negative sign (2012:12).With this last reference, this essay proves to contain theoretical, empirical and analytical evidence of the role of institutions in the development process.

After restating that any development process is affected by a variety of causes, I chose institutions as the most convincing variable at the top of the casuistic pyramid influencing this process. Institutions are able to create changes not only in the economic field, but also in the political and social sphere, which is fundamental if we wish to create a cohesive theory of change. They are able to trigger a sustainable change, since institutions are able to transform endogenously, adapting to the new needs of society. Therefore, institutions meet both requirements I stated at the beginning of this essay, proving to be able to create the kind of development I look forward to seeing in the world. Pointing out one variable has proved to be useful from a personal point of view, even though I understand that a necessary follow-up to this essay should attempt to determine the right structure and performance for an institutions to successfully create development. Personally, I believe that inclusive and pluralistic institutions could ease the plight of all those who are made to feel invisible by poverty. Moreover, accountable institutions mean that society can effectively renew them thus ensuring they fulfil their mission.

Karen Sims

Institutional Structures as the Primary Factor for Growth and Development

INTRODUCTION

"Oh, what a tangled web we weave, when first we practise to deceive." Replacing "deceive" with "develop" may ruin the rhyme of Sir Walter Scott's poetic original, but the concept applies equally well. A look at any introduction to development economics first-day graphics shows so many factors, so many relationships, so many complex interactions – a tangled web, indeed. All too often, off to the side, or in the smallest box on the page, one finds "Institutional Structures", appearing almost as an afterthought. And yet, a country's institutional framework, and the extent to which it is the embodiment of its culture, is the most important factor in development, outweighing geography, natural resources, history, and even its economy.

There are countries that share geographic locations but are vastly different in terms of economic development. An abundance of natural resources may fuel one country's progress but have minimal impact on another. Some former colonies thrive; others languish. The world has wealthy autocracies and impoverished democracies. Economies are volatile.

Soedjatmoko, former Indonesian representative to the United Nations, is quoted by Todaro (2006: 13): "Looking back over these years, it is now clear that, in their preoccupation with growth and its stages and with the provision of capital and skills, development theorists have paid insufficient attention to institutional and structural problems and to the power of historical, cultural, and religious forces in the development process".

In his 1993 Nobel Prize lecture, Douglass North defined institutions as "the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions) and informal constraints (norms of behavior, conventions, and self imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies."

Without incentive, there is no economic activity. A person who is hungry wants to eat and so hunts or gathers or steals or goes to a job to earn money to buy food. A hungry person is incentivized. But what about the enforcement characteristics? Is stealing condoned by his/her society's conventions? Is hunting or gathering or employment valued?

We start with a single individual operating in a local context, at the most basic level, a family. And that family is part of an extended family, which may be part of a clan. And that clan operates in a higher context, perhaps a village in a region. And that region is part of a political institution, typically a country with a constitution (enforced or not), including those countries whose constitutions are based on sharia. At every level there are social conventions (institutions) that either constrain or incentivize the players.

RESEARCH AND LITERATURE REVIEW

Easterly (2006: 64) postulates that social institutions and norms are crucial in preventing market participants from engaging in opportunistic behavior, what most people term cheating. While self-interest can be socially beneficial, there must be norms to ensure “mutually beneficial transactions between parties. Lack of checks and balances on greed can prevent economic development just as a lack of markets can.”

The World Bank (2012) takes this several steps further. “An active state with good governance in both the public and private sectors fosters an environment where contracts are enforced and markets can operate efficiently. It also ensures that basic infrastructure functions, adequate health and education services, and social protections exist, and people can participate in decisions that affect their lives.”

By analyzing three determinants of development – geography, international trade integration, and the quality of institutions (measured as the “protection afforded to property rights as well as the strength of the rule of law”), Rodrik and Subramanian (2003) conclude that institutional quality is the most important of the three. They found that geography has weak direct effects on incomes while trade has no direct positive effect on income. The types of institutions that the authors believe foster long-term development are market-creating, market-regulating, market-stabilizing, and market-legitimizing. Rather than dictate what form these institutions should take, they recommend a hybrid approach to accommodate context-specific differences in history, geography, and political economies, with democracy acting as a facilitator in shaping institutions within a country. The authors conclude with a proposal for increasing aid effectiveness: “The need is to find the right institutional preconditions rather than to micromanage outcomes.” (p. 34)

Looking at the clan/family level, Granato, Ingleharg and Leblang (1996) constructed an index of achievement motivation based on data from the World Values Survey and compared it to mean rates of per capita economic growth between 1960 and 1989. They found that a strong linkage between economic growth and societal emphasis on thrift and determination versus obedience and religious faith.

Sapienza, Zingales and Guiso (2006) define culture as customary beliefs and values that are transmitted from generation to generation without significant change. One of the economic outcomes they examine is savings. A society’s emphasis on educating

children about thriftiness correlated positively with an increase in the national savings rate. The authors concluded that cultural variables are equally important as economic variables when comparing cross-country differences in national savings rates.

CONCLUSION

Family values passed from generation to generation and good governance represent cultural values at the micro and macro levels of society. An institutional framework can be as small as a single-parent family or as large as an international federation. At every level in between, cultural norms define the constraints and incentives applicable to the participants. As suggested by the research findings summarized above, culture and institutional norms impact economic development. Just as a family that doesn't save rarely improves its lot, a government that squanders natural resource rents jeopardizes economic growth.

To foster development, societies must be willing to adopt and implement norms that induce economic growth. Only when the players in a game are sure of the rules and know that the rules will be enforced can they participate fully. When the institutional framework of a country is focused on equitable development, everybody wins.

Nuria Calleja

INTRODUCTION

This essay starts explaining briefly the correlation between growth and development from the perspective of different experts in order to stablish a general context. From this point, the most important topics that affect development will be described: foreign trade in the higher income developing countries and human capital in the lower income developing countries.

MAIN IDEAS

Development is not just an economic phenomenon. It is a multidimensional process involving with economic, structural and institutional changes (Todaro 2006).

There's a correlation between development and growth. Growth reduces the proportion of people who are poor, makes the lives of poor people better and frees the poor from hunger and disease. To find their way from poverty to riches, it's necessary to remind that people do what they get paid to do, so if they have the right incentives, development will happen. If they don't, it won't (Easterly 2001).

If we look at the data more deeply, we can find the studies of Ravallion and Chen who asked themselves how aggregate economic growth changes the share of people below the poverty line -understanding the poverty line as the part of the population who have incomes below 1USD a day-. The answer for them is quite clear: fast growth goes with fast poverty reduction, and overall economic contraction goes with increased poverty. Countries with positive income growth have a decline in the proportion of people below the poverty line. For poverty to get worse with economic growth, the distribution of income would have to get much more unequal as incomes increases (Ravallion and Chen 1997).

This is indeed what Dollar and Kraay have found: a 1% increase in average income of the society translates one for one into a 1% increase in the incomes of the poorest 20% of the population. Again using statistical techniques to isolate direction of causation, they found that an additional one percentage point per capita growth causes a 1% rise in the poor's incomes (Dollar and Kraay 2000).

Also, the opposite correlation is been confirmed by Alesina and Rodrick: the more unequal the distribution of resources in society is, the lower the rate of economic growth is (Alesina and Rodrik 1994).

So, pointing all these perspectives, which are the tools to increase growth and development in developing and underdeveloped countries?

Barro got some information for a broad panel of countries over 30 years in order to isolate determinants of economic growth: with respect to government policies, the evidence indicates that the growth rate of real per capita GDP is enhanced by better maintenance of the rule of law, smaller government consumption, and lower inflation. Increases in political rights initially increase growth but tend to retard growth once a moderate level of democracy has been attained. Growth is also stimulated by greater starting levels of life expectancy and of male secondary and higher schooling, by lower fertility rates, and by improvements in the terms of trade. For given values of these variables, growth is higher if a country begins with a lower starting level of real per capita GDP; that is, the data reveal a pattern of condition convergence (Barro 1991).

Blomstrom affirmed that this "conditional" convergence was particularly strong among the poorest half of the developing countries. Inflows of direct investment were important influence on growth rates for higher income developing countries but not for lower income ones. For the latter group, secondary education, changes in labor force participation rates, and changes in the price structure were all mayor factors (Blomstrom et al. 1994).

So, following Barro and Blomstrom, we will divide the essay depending on the income of the developing countries because their growth and development is mainly affected by different issues.

For the higher income developing countries, foreign trade is the main issue to grow: ideas with regard to trade policy and economic development are among those that have changed countries radically. It is now widely accepted that growth prospects for developing countries are greatly enhanced through an outer-oriented trade regime and fairly uniform incentive for production across exporting and import-competing goods. Some countries have achieved high rates of growth with outer-oriented trade strategies. Policy reform efforts removing protection and shifting to an outer-oriented trade strategy are under way in a number of countries. It is generally believed that import substitutions at a minimum outlived its usefulness and that liberalization of trade and payments is crucial for both industrialization and economic development. While other policy changes are also necessary, changing trade policy is among the essential ingredients if there is to be hope for improved economic performance (Krueger 1997).

Related to the foreign trade issue, Jeffrey Sachs concludes that "the more important differences seem to center on exchange rate management and on the trade regime" and that there are a number of reasons why the difference of orientation can affect growth, both in short and long run: makes it possible to use external capital for development without encountering serious problems in servicing the corresponding debt and it also generally results in more rapid growth of exports (Sachs 1985). Nishimizu completes the last idea adding that foreign trade accelerates technological advance in developing economies (Nishimizu and Robinson 1984).

Referring to the poorest countries, Todaro says that human capital—health, education, and skills—is vital to economic growth and human development, and also

that there are strong synergies (complementarities) between progress in health and education (Todaro 2006).

Becker affirms that education, training, and health are the most important investments in human capital and that economists in general regard expenditures on these issues (Becker 1975).

This author, joined by Murphy and Tamura studied the correlation between human capital, fertility and economic growth. They agreed that when human capital is abundant, rates of return on human capital investments are high relative to rates of return on children, whereas when human capital is scarce, rates of return on human capital are low relative to those on children. As a result, societies with limited human capital choose large families and invest little in each member; those with abundant human capital do the opposite and this leads to two stable steady states (Becker et al. 1990).

According to human capital, Ray illustrates the inability of a section of the population to build up an adequate nutrition and health which is bad by itself but in addition contributes to inefficiencies in work productivity; the inability to access to primary education; and the inability to become an entrepreneur, even though this choice promotes economic efficiency. By investing money in the acquisition of human capital, the poor person can possibly have a higher return on this money than the rich one (Ray 1998).

CONCLUSIONS

There is a general agreement in the correlation between growth and development but there is not when we talk about the main issues to reach the development of the countries. We should make a difference between the poorest countries and the developing countries but, in all the cases, we can never talk about just one solution. When the country reaches a medium standard of life, the openness of foreign trade can be crucial to increase development but when the standards are low the efforts must be concentrated in increasing human capital as a whole.

Teresa Boada Serret

Growth Towards Development

Introduction

"Prosperity happens when all the players in the development game have the right incentives" (Easterly 2001: 289). Following Easterly statement, we come to understand that the final purpose of *development* is the enhancement of the well-being of societies (Todaro and Smith 2012), for which *growth* is determinant in terms of potential investments in collective goods, like health, education and law empowerment (Easterly 2001). Accordingly, I have decided to focus my essay in *income level* and *healthcare indicators* as the main transformers of people's living standards. Throughout this paper I will explain these concepts and their measurement approaches, supporting my idea with statistical evidence of how the selected variables enable the progress of countries through a *double causality effect.*

Growth and Development

It may seem too narrow a definition, but some economists describe economic development as the level of per capita income and its growth rate, stating that income patterns involve many other aspects of societies (Lucas 1988). In fact, originally economic development was defined in terms of Gross National Income (GNI) **growth** (5 to 7 percent) and production structural changes (measured as the increase in the share of manufacturing and service industries, in detriment of agriculture's) as it was assumed that cumulative growth would "trickle down" to the whole population allowing for the distribution of wealth (Todaro and Smith 2012, Debraj 1998). However, economists soon realised that income growth not always led to development, due to the unequal distribution of wealth (like the case of Latin America) and the range of possibilities[1] granted to individuals (Todaro and Smith 2012).

The economic growth mission drift, led to the redefinition of **development** as a broad multidimensional concept involving the economic, cultural, political and institutional reinforcement of societies with the ultimate goal of improving the living conditions of the majority of the population (Todaro and Smith 2012). Regarding this aim, development is widely measured in terms of *income*, defined as real income per capita[2], *health,* assessed by life expectancy at birth[3] and *educational attainment*, conceived as mean and expected schooling years, that together compound the *Human*

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[1] Amartya Sen's Capability / "Functionings" Approach (Todaro and Smith 2012).

[2] GNI per capita at constant prices and adapted to the Purchase Power Parity to provide more accurate comparisons of living standards across developed and developing countries (Todaro and Smith 2012).

[3] The average number of years a newborn would live if prevailing patterns of mortality at the time of his/her birth were to stay constant throughout his/her life (World Bank 2014).

Development Index (HDI), ranging from 0 to 1 (UNDP 2014). Other relevant indicators for health would be the under-five mortality rate or the rate of undernourishment and for education, the literacy rate (Debraj 1998).

Overall, growth is a "prerequisite" to increase well-being, regardless the income level of the population (Debraj 1998, Easterly 2001), but it does not always imply development, as Easterly (2001), Todaro and Smith (2012) highlight with Pakistan case.

Income and Health as Key Variables for Development

In 2013 the under-five mortality rate in low-income countries was 76 out of 1,000 live births, more than 12 times the average rate in high-income countries (UNICEF 2014). In line with this, renowned economists have found a *strong association between the evolution of economic growth and infant and child mortality* (Easterly 2001). In particular, several researchers associate a 10 percent decrease in income with a 6 percent higher infant mortality [4], mainly caused by communicable diseases (tuberculosis, syphilis, diarrhoea, meningitis, hepatitis, leprosy, etc.) preventable with inexpensive medicines (Easterly 2001).

According to Pritchett and Summers (1996), with one percent higher incomes in the developing countries, up to 53,000 child deaths would be prevented each year. Consistent with Preston (1975), half of the raise in life expectancy (17 years) in developing countries between 1940 and 1970 was prompted by higher levels of income per capita and improved living conditions. It must be noted that most authors encounter diminishing returns to income in terms of health indicators for better off countries (Pritchett and Summers 1996).

Moreover, numerous economists have stated a *backward casualty effect*. For instance, according to Gallup and Sachs (2001), countries suffering from intensive malaria grew 1.3 percent less per person and year (partially due to foreign investment slowdown) during the period 1965-90. Based on their correlation revision, if malaria transmission was reduced by 10 percent, affected countries' income growth would be 0.3 percent higher (Gallup and Sachs 2001).

But not only health improvements have an effect in extreme situations, there are multiple circumstances under which healthiness can accelerate income progress, through its effects on labour market participation, worker productivity, investments in human capital, savings, fertility and population age structure (Bloom and Canning 2005). Indeed, several studies provide evidence. Bloom and Canning (2005) assert that, when adult survival rates improve by 1 percent, labour productivity increases by about 2.8 percent. Likewise, an additional model allies a 10-year increase in longevity with a 4.5 percent rise in savings rates, establishing a causal interrelationship along the whole lifecycle (Bloom, Canning and Graham 2003). According to Cervellati and Sunde (2011),

[4] Pritchett and Summers (1996) state that whatever impact income has on infant mortality (under-one) is applicable to child mortality (under-five).

upon demographic transition[5] - to which societies are prone as life expectancy improves - reductions in mortality lessen population growth (for the fertility rate adaptation to reduced child mortality), and foster human capital skills raising per capita income.

Conclusion

The above data supports the fact that the combination of income and health boost allows for the completion of the *three core objectives* of development[6]. Since 1990 the world's average HDI has risen from 0.597 to 0.702 (UNDP 2014), entailing 60 percent (absolute) growth in real income (from 8,331 to 13,323 constant 2011 international USD) and 7.8 percent (absolute) progress in life expectancy (from 65.7 to 70.8 years) (World Bank 2014).

The achievement of development follows a cycle: higher income enables *self-sustenance* and once population is free from hunger and disease it can accomplish demographic transition reducing its growth rate. At this stage, societies may invest in education fostering human capital formation that would favour increased productivity and reduced unemployment. A stable socio-economic and healthy context, together with more competitive labour force, might attract foreign investments allowing for the enhancement of the institutional framework. Backed by reinforced workers and institutions, the country is to initiate production structural changes, with the aim of diversifying exports and becoming stronger at international trade. All these steps improve *living standards* and national *self-esteem* as individuals gain access to a broader range of *economic and social choices* (including saving opportunities, social and leisure services), permitting in the last place *to break up the underdevelopment vicious circle.*

[5] Its consideration allows for the contraction of the population growth claimed by other economists to have a negative causal effect on income per capita (Cervellati and Sunde 2011).
[6] Following Todaro and Smith (2012): self-sustenance, improved living standards (self-esteem), freedom.

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