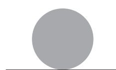

COMMENTARY

The Evolution of Development Economics and East Asia's Contribution

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Shahid Yusuf has summarized the 30-year history of the *World Development Report* (*WDR*) in light of the intellectual evolution of economic development philosophy. The review is quite extensive, and it goes beyond a summary of the history of the *WDR*. The reader benefits from Yusuf's insights about how development economics has changed and how political priorities in development have changed over more than the 30 years (the history starts well before the *WDR* was born). Yusuf's writing is filled with the pride that the *WDR* was the first major publication of this kind by an international financial organization.

In the essay, chapter 2 reviews the historical development of the *WDR* from volume 1 to volume 30. Chapter 3 covers crucial issues that have been debated, and chapter 4 explores the direction for the future.

Comments on the Essay

In explaining the history of the *WDRs*, Shahid Yusuf has successfully identified three different threads: changes in the president and chief economist of the World Bank, changes in *WDR* emphasis, and changes in development economics literature. Those who were remote from politics

in Washington, D.C., and the World Bank would learn with interest how changes in the presidency have altered both the Bank's and the *WDRs'* emphasis.

In 1978, President Robert McNamara and Chief Economist Hollis Chenery created the first *WDR*. According to Yusuf, Chenery "encouraged McNamara to pursue the idea of an annual publication," and "McNamara entrusted Chenery with the task of preparing a flagship report." The first report was only 68 pages long. Increasing length has both benefits and costs. Yusuf admits that the report has become so large that few now read beyond the executive summary.

Transition from McNamara and Chenery to President A. W. Clausen and Chief Economist Anne Krueger shifted the Bank's emphasis from a dual objective of growth and poverty alleviation with macroeconomic emphasis on the availability of external finance, to microeconomic advice on getting the prices right. Krueger, "a staunch advocate of market solutions, … hitched the Bank's approach to development firmly to market forces." In the 1980s, the political environment of Ronald Reagan and Margaret Thatcher also influenced thinking in development economics. Yusuf notes that the pendulum swung from state help to the market because of the failure of the state in many regions, but the pendulum swung too far because of ideology.

A big change occurred when James Wolfensohn became president in 1995. It is interesting to know that Wolfensohn "desire[d] to contain the influence of economists in the Bank." Was this economics in the narrow sense? I ask this question because both Amartya K. Sen and Douglass North, who were supporters of Wolfensohn, are economists—Nobel laureates—after all. Joseph Stiglitz, chief economist from 1997 to 2000, is also a Nobel laureate. It must have been a shift of emphasis within economics broadly defined.

In the 2000/2001 *WDR*, Yusuf describes the following new consensus. "Growth was necessary but not sufficient," which he observes completes "almost [a] full circle … to the views expressed in the earliest *WDRs*.… It had to be supported by infrastructure and other services so as to build human capital, especially among the poor, and to lessen the inequity of assets and incomes." Is this observation encouraging or discouraging? The Bank's views shift as Bank executives—president and chief economist—change, as

explained well in the earlier pages. The new consensus is more a matter of course than a big surprise or new insight for Asians and continental Europeans. In those economies, the government has played an important role in education, from primary to advanced, as well as in social and economic infrastructures. Deregulation and liberalization were conducted in a gradual manner. Is going full circle over some 20 years a reflection of the changing ideology and political environment of American economics and politics? Maybe the history suggests that the World Bank should be modifying its tradition so that presidents, vice presidents, and high-ranking economists from France, Germany, Japan, and other non-Anglo-Saxon economies are represented in addition to mainstream fashion in American economics. Appointing a chief economist from China may be a good start.

Yusuf concludes the summary of his 30-year history by noting three shifts over the years:

1. From state directed to market guided
2. From structural issues to sectoral issues
3. From macroeconomic concerns to microeconomic concerns

This summary succinctly captures the changes of emphasis over three decades quite well. They all seem reasonable, but again the balance is important. In this connection, it is commonly believed that a division of labor exists between the International Monetary Fund (IMF) and the World Bank. The IMF is in charge of macroeconomics and sectoral issues rather than microeconomics and structural issues. From this point of view, the shift in emphasis from macro to micro in the World Bank makes sense. This shift may be viewed as a welcome retreat from "mission creep." But in terms of the second shift, shouldn't the World Bank continue to address structural issues as well as sectoral issues?

In chapter 3, Yusuf takes up important topics where debates continue. In the section on "Growth through Perspiration," the debate over the source of growth, whether capital accumulation or total factor productivity (TFP), is reviewed. Certainly, increasing investment is important, but it is difficult for some countries to achieve. TFP is also difficult to promote by policy, although education and knowledge would possibly increase TFP. In the section "From Machines to Institutions," Yusuf reviews the debate over whether growth comes first and institutions follow or whether good

institutions are a prerequisite for growth. The idea of "Inspired Growth" became popular in the literature of new growth theory, but in reality the bulk of growth comes from capital accumulation. In the section "Resource Balances and Capital Flows," various issues on use of foreign capital are reviewed. The so-called Washington Consensus is discussed. Then the discussion on the "Role of the State" is a recap of the changes in thinking over time. As Europe has implemented denationalization since the mid-1980s, the role of the state has been reconsidered downward. The *WDR*, however, took a position that privatization and denationalization should be done in a gradual manner. That idea seems to be a departure from the more radical thinking of Big Bang. However, Yusuf seems to disagree with the *WDR* interpretation of the East Asian miracle as an unqualified endorsement of market economy; the government did not withdraw from failing industries. East Asia remains a paradox in the mainstream view of the role of state. The section "Reducing Poverty" describes changing thinking about poverty reduction, from meeting the basic needs in the late 1970s and early 1980s to promoting "pro-poor" development strategy. The pro-poor policy is to promote human capital development that would contribute to decreasing poverty and encourage less unequal distribution of income. The section on "Aid and Growth" gives an important recap on the use and effectiveness of aid—a first step to rid the world of poverty. A consensus hardly exists in the academic literature about how big aid should be.

In a section called "A *WDR* Policy Scorecard," Yusuf gives a high mark to the *WDR* for having been "powerfully instrumental in raising awareness on the extent of poverty and in exhaustively cataloguing the many ways of erasing it." It identified the importance of capital investment and, later, human and knowledge capital for growth. But Yusuf admits that the "*WDRs* are silent on what it takes to reach 35 percent rates of capital investment."

Chapter 4 is about the future of the *WDR*, "Where To Now?" Yusuf lists the future challenges. First, he shows the long-term data of per capita GDP growth of the Republic of Korea and the United States. Both show the steady growth of income with some fluctuations around the trend, with the U.S. growth rate lower than Korea's (figures 4.1 and 4.2). The point of the figures is whether economic policy made any change over the long-term

natural force (autonomous growth). It seems a bit unfair to show the two more or less successful cases and a good period for Korea. In addition, the long-term data mask the occasional deceleration and acceleration.

Yusuf then explains the importance of institutions. His understanding seems to be much more reasonable than what is commonly seen as the Washington Consensus, however. The following sentences struck me most as a promising starting point for future direction:

> The interest of policy makers lies not in whether the state should be large or small or more or less interventionist; the interest is in what specific forms of intervention over a period of time yield the best results under similar external circumstances. The same is true regarding institutions. Everyone can see that market institutions in successful East Asian industrializing countries are at best functional and at worst weak and minimally supportive.

Yusuf raises five specific topics that he considers key for the future of the *WDRs*: "Putting Knowledge to Work," "Warming Climate, Scarce Water," "The Geography of Human Habitation," "Resilient Complex Societies," and "An Equal Marriage of Politics and Economics." Each of these topics has a large literature behind it and controversial, ongoing debate in front. This comment is not the place for lengthy arguments; however, let me point out some important missing pieces. As mentioned in the beginning of this section, a puzzle remains: When the "technology of development" is so widely shared—not the least through the *WDRs*—why are there so many laggards? Why is there a great and widening divergence? Why aren't the ranks of "tiger economies" growing by the year? These questions should be highlighted. The World Bank may put more focus on the least developed countries, defying the logic of development and growth that predicts a takeoff. *WDRs* may have been putting too much emphasis on analyzing successful middle-income developing countries, and the World Bank has been busy lending to those good-credit borrowers. Memory of poor performance of the "laggards" may have been erased with debt reduction. The World Bank may be well advised to shift its resources from China and India—where the private sector as well as the World Bank can do a lot—to Africa and to the poorer countries of Latin America and Central Asia. The future research plan should include a serious analysis of the laggards, however painful and politically difficult it may be.

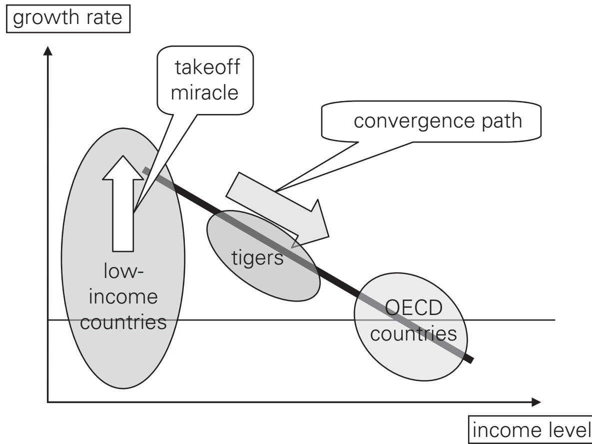
Big Push, Development, and Growth: A Synthesis

In the past, economic development and economic growth were two different subjects. On the one hand, development deals with long history, institution building, big government policy, structural changes, and transition of industrial structures, for example, from an agrarian economy to a manufacturing economy, and to a service-oriented, advanced economy. Quantifying development success or failure is often very difficult, but case studies are needed. On the other hand, (old) growth economics stresses the commonalities across countries. When a country is equipped with capital, labor, and technology, then growth occurs. With the initial state of income level, the production function, and the saving rate being given, the rest is automatic. No policy is needed. No institution is needed. Convergence to the steady state is autonomous and guaranteed.

With the emergence of new growth theory, the line between development and growth theories has been blurred. Emphasis on institutions—repeatedly mentioned by Yusuf—is a hallmark of new growth theory. Factors that influence growth (convergence) are now on the right-hand side of growth regressions. However, new growth theory emphasizes standardization and quantification so that cross-country regressions can be implemented. Also, regressions need a long enough data series with a fixed starting year, often taken as 1960. Policy change and reforms and structural breaks cannot be treated at the same level of detail as in standard development economics.

The most difficult part of development and growth is the miracle of lifting a low-income country from a low-growth trap to a reasonably high-growth path. The four tigers—Hong Kong, China; Taiwan, China; Korea; and Singapore—made that transition in the 1970s. East Asian economies made the transition in the 1980s, and China and India accomplished it in the early 1990s. Once the country moves from a low-income, low-growth state to low-income, high-growth state, then the "convergence" of growth theory works, unless political meddling hinders the process. The initial miracle—Big Push or takeoff in the old development theory—is the key and not known even in the series of *WDRs*. The takeoff part desperately needs a building up of institutions, reforms, policy interventions, and so on. Once a country is on the

Figure C.1: The Transition to a High-Growth Path



Source: Author.

convergence path, a gradual withdrawal of policy interventions may be desirable, and old and new growth theories apply. This view is shown in figure C.1 (see also Ito 1995, 1998). A similar pattern is empirically established in Ito (2000).

It is obvious from figure 1 that linear growth regressions that mix pre-takeoff countries and tiger-OECD countries would not yield clear-cut results. The importance of institutions matters most for the takeoff.

Underappreciation of East Asian Experiences

A delicate relationship has existed between East Asia and the World Bank over what is the right development strategy. Policy makers in East Asian economies felt that government interventions in identifying sunrise industries and allocating scarce resources, including foreign exchanges, were helpful in industrialization. However, these government interventions were regarded as a source of distortion and corruption in the rest of the world and in mainstream World Bank thinking. Yusuf mentions the East Asian tigers as a case for openness:

> These economies were portrayed as single-mindedly pursuing growth through the export of manufactures, relying mainly on market forces to guide the allocation of resources and exploiting the advantages of greater openness to gain access to

> overseas markets and to ensure the competitiveness of their industries. Although the degree to which market forces were responsible for directing resource flows to areas of comparative advantage was far less than was assumed, and although most tiger economies nurtured industries behind trade barriers, the East Asian economies, by virtue of their successful growth performance, became the ones to emulate.

This quotation is a very diplomatic description of the political-economy controversy that took place between East Asia and Washington, D.C., in the 1980s. In this respect, it was not the *WDR*; rather, a special World Bank study that resulted in *The East Asian Miracle* (World Bank 1993) was comprehensive in taking up both views and striking a good intellectual balance.

The high economic growth of the four tigers was followed by the growth of several southeast Asian countries, including Indonesia, Malaysia, and Thailand. As a region, Asia seemed to be a successful case. The Asian crisis of 1997 and 1998 dented Asian confidence. However, since 2001, the Asian region, with China and India, has become the center of world growth again. Asia presents a difficult case for both those who advocate market solutions and those who are more sympathetic to government interventions. The *WDR* could have taken East Asian experiences more carefully with respect to the true reasons for success and transferability of the lessons to other regions. The crucial differences between the Asian developing countries and developing countries in other regions, especially the laggard countries, should be identified and analyzed.

In summary, the East Asian miracle seems to be a miracle still—a miracle of takeoff, a transition from a low-income, low-growth state to low-income, high-growth state. That magic should be the focus of the *WDR* in the future, and the experiences of East Asia, including China and India, will be worth taking seriously.