The Failure of Economic Development

Interview with William Easterly

Development economists once were optimistic that the nation's poor countries could grow rapidly. This World Bank economist, who advocates mostly mainstream views, claims that these policies have failed in the past two decades. Here is the record, with his views on why it is so poor.

Q. Twenty or twenty-five years ago, economists at the World Bank and specialists in economic development were quite optimistic about the possibilities of growth in poor and developing countries. But the record has been disappointing. How have economic development policies fared in the last quarter century or so?

A. Unfortunately, the record is one of failure. The efforts that we as development economists, aid donors, and policymakers have made have not worked, and the typical developing nation has not seen its living standards rise in the last two decades. These countries have the same standard of living as they did in the 1980s.

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Q. How do you define the standard of living?

A. Per capita income, gross domestic product per capita—the total production of the economy divided by the number of people.

Q. So when we say the living standards have not risen for the typical country, is that true for the majority of countries?

A. The rise in living standards in the typical developing country over the past two decades was zero.

Q. And the median rate of GDP per-capita growth over this period was zero?

A. Yes.

Q. Were you with the World Bank in 1980?

A. No, I joined in 1985. I did start working on developing countries around 1980.

Q. And what was the general sense then?

A. Very optimistic. Things had gone very well in the 1960s and 1970s in developing countries. They had grown about as fast as the rich countries, and some of them considerably faster, such as those in East Asia. And Brazil was having a big success then. There were African success stories like Côte d'Ivoire. There was a lot of optimism, but there was a huge reversal of fortunes just at the time when much of the advice that is standard today was becoming fashionable. All the advice about promoting capital investment, education, and family planning, giving structural adjustment loans and debt forgiveness—all of that was happening in the 1980s and 1990s. And just as all these efforts should have been bearing fruit, they failed.

Q. Why did developing nations do so well in the 1960s and 1970s?

A. It is a bit of a mystery why they did well. It surprised everybody.

Q. Were the 1960s and 1970s essentially different decades?

A. Yes, the 1970s were much more turbulent. The 1960s was more the golden era—that is, 1960 to 1973.

Q. The 1970s were highly inflationary.

A. In the 1970s we had a great deal of macroeconomic turbulence and instability in many developing countries.

Q. So if we were to split those two periods for analysis' sake, the developing world did pretty well in the 1960s and early 1970s.

A. Yes. And ever since then, it has done poorly.

Q. But in the late 1970s the developing world probably did pretty well because commodities prices were rising with inflation.

A. Of course, those who were oil exporters were doing well because oil prices were high after 1973.

Q. What about other natural resources?

A. Other commodity prices were also doing fairly well in the 1970s. There was the coffee boom, there was a cocoa boom, earlier there had been a copper boom, which really helped out an economy like Zambia's. And world trade was really expanding, it was having very rapid growth, so those countries that chose to get on the world trade bandwagon did very well. They were able to export a lot, and that helped their growth.

Q Wasn't there a lot of import substitution policy, tariffs, and so forth in the 1960s?

A. Yes. That is why I say the growth had a lot of mystery for me.

Q. But maybe not for people who advocate import substitution policies.

A. It is mysterious to those who advocate hands-off markets. The 1960s and 1970s were a period of better performance than post-1980 when the neoliberal consensus reigned supreme. To be fair, the rich countries were growing much faster in the 1960s and 1970s, and that is part of the story, too—that the rich-country markets were growing much faster and importing much more from the developing world, keeping the commodity prices high. That is a big factor in explaining why developing countries did better in the 1960s and 1970s.

Q. In the early 1980s, you point out in your new book, *The Elusive Quest for Growth,* the World Bank predicted that the growth rate of developing countries would be something like 3.3 percent per capita a year, which is very rapid by any standard.

A. Yes. And that was their baseline forecast. Their pessimistic forecast was something like 2.5 percent, and, of course, the reality was zero. This was a huge disappointment relative to what was expected. And when the World Bank and International Monetary Fund were giving all these structural adjustment loans, the slogan of the day was "adjustment with growth." Let us promote adjustment, but let us also promote growth. So we expected a lot of growth from structural adjustment, but it did not happen.

Q. What was structural adjustment? What did that actually mean?

A. In countries that were running large trade deficits, had large government budget deficits, and had exchange rates such that exports were penalized and imports were very cheap for consumers—these circumstances, it was believed, had to be corrected, a process called structural adjustment. In addition, it meant correcting other kinds of interference with free markets, such as controls on interest rates, price controls on certain food staples, and controls on buying foreign currency. Structural adjustment meant getting rid of the black market in foreign currency, the overvalued exchange rate, the price controls, the government deficit, and the trade deficit.

Q. If countries were doing fairly well in the 1960s and 1970s, what provoked this new attitude on the part of the World Bank?

A. In the second half of the 1970s, the developing countries started to lose economic control. Many of them began to run large government budget deficits. They were able to keep the growth going for a while in the first half of the 1970s by heavy borrowing. But when commercial banks suddenly realized, after the Mexican financial crisis in 1982, that many countries were not creditworthy, they also stopped lending. The lending boom that had helped to keep growth going came to a halt, and then growth really declined.

Q Let us go back to an earlier stage of thinking about economic development. In your book, you point out the early idea that a big disadvantage for these countries was that their people just did not earn enough to be able to save and, therefore, invest. So the idea was to provide them aid to compensate for their lack of savings. What is the evidence that that actually failed—or did it fail?

A. It did fail, unfortunately. There were two links that we thought would hold: The first was the belief that giving them aid would increase investment, because we thought their low investment was simply because they couldn't afford to save very much. This created what we called the "financing gap" between the amount of investment they needed to grow rapidly and the actual amount of saving they had available.

Q. What period are we talking about?

A. This is the whole period of postcolonial development. This thinking has been the reigning paradigm of the foreign aid business since the end of World War II. The 1950s was really when it came into play, after these nations became independent, and it has remained an influential view as to how to calculate aid requirements. It is still being used today in the World Bank.

Q. On what basis do you say it has failed?

A. The two links were that aid would increase investment, and then the increase in investment would fuel growth. Neither of those links turned out to hold in the data. The aid did not go into investment. The statistical evidence says that it went entirely into consumption—that is, into people's living standards here and now, but not into investing in machinery and equipment to produce goods for the future. Second, the investment did not fuel growth. Countries like Nigeria increased their capital stock by 250 percent but increased output per worker by 3 percent in total over 1960 to 1985. And there were a lot of these countries, especially in Africa, but also many others that did not have a strong link between investments and growth. Only one country's growth lived up to expectations as predicted by the model—that was Tunisia.

Q. As predicted by the model in 1960?

A. Yes, using actual data on aid and investment.

Q. But then along came the neoliberal policy. Was it associated with the change in the administration of the World Bank?

A. The intellectual change really came when Ann Krueger, the Stanford University economist who is now the IMF first deputy managing director, was chief economist of the World Bank in the early 1980s. She led the intellectual revolution toward the neoliberal consensus of free trade, noninterference with markets, macroeconomic stability, and reducing government budget deficits.

Q. So why did these policies not bring growth?

A. In part, because those policies were never fully tried. These IMF and World Bank loans were given conditional on making these policy changes. But it turned out that countries often did not do what they had supposedly agreed to do. They often did not change the policies, so they did not really become more free trade–oriented, more market-oriented. They did not actually

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reduce the budget deficit, or the trade deficit. Yet the IMF and the World Bank kept giving adjustment loans anyway because there was a lot of political pressure on them to give current loans to the strategic developing countries like Zaire. President Mobuto Sese Seko of Zaire, who was a strategic ally in the cold war, got nine structural adjustment loans from the IMF and the World Bank.

Q. So you are claiming that for those that did adopt structural changes, such as free markets and macroeconomic stability, it worked?

A. Where they were actually tried, they did work.

Q. And what do you base that on?

A. Comparing countries' growth rates and seeing what the fast-growing countries did in contrast to what the slow-growing countries did. And you find that the fast-growing countries generally did have more market-friendly policies. Not that there was no interference by government, but they did not have any huge distortion of free markets or big macroeconomic problems such as huge budget deficits or trade deficits.

Q. But aren't these correlations ambiguous in the sense that what you might measure as neoliberal policies are the consequences of being in different stages of development, or a variety of other factors that affect these kinds of measures?

A. Yes, there is the concern that it could be a spurious association—correlation is not causation. It could just be reflecting some third factor such as generally good government, good government institutions, or favorable economic culture. There is always that possibility.

Q Most of these structural reforms were aimed primarily at stabilizing and reducing inflation, were they not?

A. Yes. Inflation and government budget deficits were the big targets.

Q. But even when you talk about reducing inflation, were there still other possible factors affecting these correlations?

A. Yes. It is the great calamity of being a statistical researcher—you always have the possibility that there is some third factor lurking in the background.

Q. Or a fourth, fifth, or sixth factor.

A. Yes, that could be driving both inflation and growth.

Q What would have happened if the World Bank had made loans only to those countries that adopted structural reforms that you think were useful? What would have happened to those other countries?

A. The other countries did not benefit from getting the adjustment loans without making policy changes, and so if they did not benefit under those circumstances, then they would not have lost much by not getting those loans. There was a group of thirty-six countries that got ten or more adjustment loans from the IMF and World Bank, and their per capita growth rate was zero, just like the rest of the developing world.

Q Some economists, including a World Bank publication, attributed much of the good performance in East Asia to industrial policies or government policies that promoted exports.

A. Well, neoliberal policies had a lot to do with growth in these countries. But there were also export subsidies, and these countries had high levels of education and evenly distributed income and property.

Q You mention Argentina, of course, as an example of a country that adopted desirable structural reforms and did quite well for a while. It has not been doing too well since 1995 or 1996.

A. There are various explanations for their problems today, but the Argentine example makes it more difficult to defend neoliberal policies alone, I agree.

Q Let us talk about some of the other surprising conclusions of your book. Everybody talks about education as if it is the panacea for development, or at least one of the two or three most important factors. You are skeptical of that.

A. Over and over again, people have said education is an important answer. But when you look at the data of the countries that have increased education advancement most rapidly, they have not grown rapidly.

Q. Are they aiming at a primary education?

A. They're aiming at both primary and secondary education. They have had very rapid growth in both. So the average skill level of the labor force, as measured by the years of schooling that they have attained, has grown enormously, yet the workers are not more productive than they were before getting all this education.

Q But a high level of education, as opposed to a rate of advance of educational attainment, seems to be associated with growth. To what would you attribute the failure of new investment in education?

A. Education is another area where you have to get the incentives right. For example, the teachers have to be highly motivated to really convey learning skill and knowledge to their pupils. But often the political system is corrupt, and teaching jobs are allocated as plums or political patronage, so the teachers frequently do not have much motivation to deliver skills to their pupils.

Q. So you are saying that money is going into education, but it is not necessarily resulting in education as we think about it. It is resulting in the schools, the teachers, and kids going, but not education.

A. The schools are open, the teachers are there, all the lights are on, but nobody is home.

Q. But is this not so much a suggestion that education does not matter, but rather that it is hard to produce good education?

A. Education has not proven to be the formula on its own to promote development when other factors are not present. When the incentives are right, when teachers are genuinely motivated to deliver top results and raise students' achievements, then education can work.

Q. Another area you were skeptical about is population control. Why?

A. The same lack of evidence bedevils the population-control theory that bedeviled the education-is-the-key theory. The countries that have reduced population growth the most are not those that had rising living standards. Even some countries that have seen a slight increase in the population growth rate have grown just as fast as or faster than the countries that had a reduced population growth rate. There is no association in the data between getting population growth under control and seeing a rise in living standards.

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Q What about debt reduction as well or debt forgiveness?

A. That's another panacea that became very popular with the Jubilee 2000 campaign. Actually, what Jubilee 2000 did not fully recognize was that debt relief was not a new idea. It has been tried at least since 1979 when there was a $6 billion write-off of debt to developing nations. Ever since then, the poor countries have been getting successively more favorable terms on their debt and have been getting partial debt forgiveness. And yet, as we know, in the 1980s and 1990s when all this debt relief was being given, the economic performance was poor.

Q Let us talk, then, about the solutions. Is poverty in the world curable?

A. All of us who work in the area of development now realize that the problem is much more difficult than we had thought. We now realize that the politics of poverty is very complicated, that the governments in poor nations are often polarized between different interest groups, between different regions, between ethnic groups, between the rich and the poor. And so they wind up fighting over redistribution of the existing pie rather than having the incentive to make the pie larger for everybody. The poor

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do not have much political voice, they are not well organized, not well educated, not very articulate, so they are not able to get much out of the struggles over redistribution. The poor do not usually win when there is a struggle over redistribution of the existing pie. They only win when the pie grows larger for everybody, because that increases the demand for unskilled labor, increases the demand for what the poor have to offer.

Q So economic growth is your priority as a development goal?

A. Yes. That has proved to be the most effective means of poverty reduction in the long run—economic growth, not redistribution.

Q. On the other hand, would you argue against most, if not all, redistribution social programs?

A. We certainly want to do all we can to protect the more vulnerable members of society from bad shocks and from being critically short of life's necessities: food, water, shelter, clothing. So on the list of things that a good government should do is to have in place a program to protect the poor from utter destitution—from famine, pestilence, disaster. Unfortunately, governments in the developing world have not been very effective in doing that. That is, again, another way in which we have realized that poverty is a lot more intransigent as a problem than we used to think. The politics of the problem make it so difficult because governments in poor countries are often dominated by the elite, who do not want to limit their stranglehold on power and who view any poverty-relief program as one that could enable the poor to become more politically active and test the elite's hold on power.

Q. But there have been some cases, such as Sri Lanka, an often-cited example, where GDP per capita is not very high, but social policies have been effective in improving human development as measured by the United Nations Development Program—specifically, life expectancy and literacy.

A. Yes, and there are countries and regions that have managed to achieve many social improvements for a given level of income. India is another example. So is Cuba. But if you take a case like Cuba, how much better off would they be if they had had the kind of growth that the more successful Latin American countries have had—rapid growth of income per person?

Q Getting back to the solutions that will result in economic growth, let us talk about them.

A. We have been very naive about politics in the past—"we" meaning the whole community of development economists and professionals and aid givers. And we have not realized how much polarized politics was interfering with growth. So we have to be much more selective about whom we give loans and assistance to, with the hope that countries having these redistribution wars will not get aid thrown into that mixing bowl as yet another item to be redistributed toward the elite and the well connected. Aid should go only to good governments that have demonstrated a commitment to the overall development of the whole society, bringing well-being to the majority of the society.

Q One of the lessons that has been learned—but perhaps you disagree with it—is that there is not a single recipe for growth in any country. And yet when one advocates basic neoliberal structural policies, they seem like a cookie-cutter to me. The IMF and the World Bank keep sounding as if they want to apply them to every country.

A. Economics gives you certain guiding principles that are the same everywhere. But that does not mean that policies should be exactly the same in every country. We know from research and from studying the evidence that very unstable macroeconomics leads to poor results—extremely high inflation, high budget deficits, high public debt or external debt. One problem with structural adjustment has been that it does not discern properly what government spending should be cut, which often has resulted in desirable kinds of public spending being cut along with undesirable political patronage.

Q You also bring up the idea that policies have to be taken in context. We have to match skills, for example. There can be a poverty trap when everybody else is not educated. Then it does not make sense to get a good education yourself.

A. This is yet another reason development is so difficult. It is contrary to some ideologies that an individual's economic out-come is dependent not only on what that individual does on his or her own but also on what everyone else around them is doing.

Q. But isn't this a very fundamental argument for government, public goods, and public investment?

A. When a country is stuck in a poverty trap of the kind you just described, where nobody wants to get an education because they would just be working with other uneducated people, then you do need some government policy that gets you out of that trap. You need a subsidy to education. You need a subsidy to income creation. You have to design subsidies in a way that they really reward production and are not just another perk that the elite get hold of in their redistribution wars.

Q. Can you think of some effective examples?

A. The East Asian economy successfully did that—in essence, subsidized education and infrastructure.

Q. But you said earlier it was neoliberal structural reform that launched these countries! Maybe it is both.

A. People think these two things have to be mutually exclusive and contradictory, but both work. It works to correct macroeconomic distortions such as overvalued exchange rates and to reduce government budget deficits and to reduce inflation, and the Koreans were good at doing that. That works, that is the neoliberal side. And it also works to subsidize skill creation and infrastructure and investment.

Q. The United States gives only $10 billion in development aid. And when I speak to people at the World Bank, I always say, this is outrageously stingy. But some development economists would say: We're not sure we would know what to do with much more money from the developed world.

A. That is a real failure of imagination on the part of a development professional. There are so many serious problems out there in the developing world that need to be addressed. The eradication of malaria is an extremely urgent problem for Africa and other parts of the tropics. There is the whole AIDS crisis, a crisis of enormous proportions. You could spend the money on trying to find a vaccine for malaria and subsidizing AIDS drugs. Both would be very useful for human welfare and for economic development.

Q. What about famine relief?

A. Famine relief in the short run does save lives. You cannot argue against keeping alive someone who is threatened with death from starvation. Obviously you then make possible not only the moral good of ensuring their survival but also their continuing productivity in the future. So famine relief is another part of the social protection that should be in place in all countries and as part of an international aid strategy to protect the poor against critical shortages of any of life's necessities.

Q. Typically, don't development people separate relief from development?

A. Yes, they do. But it is a kind of artificial separation because these humanitarian crises come about not just because of something to do with the weather. Oftentimes they are caused by bad government policy, war, and other political disruptions in a country. And those elements are affected by what is going on with economic development.

Q. Do you find it scandalous that the United States gives only one-tenth of 1 percent of its GDP for aid?

A. When we can offer effective ways to spend the money, it is scandalous. When it is such a pitiful amount that we are giving now, the effectiveness of that amount is not the only priority; it is really getting more resources and spending them wisely—doing both at once. The average American taxpayer is spending a few pennies per day on aid to sub-Saharan Africa. So having politicians wring their hands about whether those few pennies per taxpayer are being spent productively is beside the point.

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