The Past, Present, and Future of Economic Growth -*Summary*

Dani Rodrik

The last decade has been an extraordinarily good one for developing countries and their mostly poor citizens. Can this recent performance be sustained into the future, decisively reversing the "great divergence" that split the world into rich and poor countries since the 19th century?

In answering this question, optimists would point to improvements in governance and macroeconomic policy in developing countries and to the still not fully exploited potential of economic globalization to foster new industries in the poor regions of the world through outsourcing and technology transfer. Pessimists would fret about the drag rich countries exert on the world economy, the threats to globalization, and the obstacles that late industrializers have to surmount given competition from China and other established export champions.

Two dynamics drive growth. The first is the development of fundamental capabilities in the form of human capital and institutions. Long-term growth ultimately depends on the accumulation of these capabilities—everything from education and health to improved regulatory frameworks and better governance. But fundamental capabilities are multidimensional, have high set-up costs, and exhibit complementarities. Therefore, investments in them tend to yield paltry growth payoffs until a sufficiently broad-range of capabilities has already been accumulated (that is, until relatively late in the development process).

The second dynamic is structural transformation—the birth and expansion of new (higher-productivity) industries and the transfer of labor from traditional or lower-productivity activities to modern ones. With the exception of natural resource bonanzas, extraordinarily high growth rates are almost always the result of rapid structural transformation, industrialization in particular. Growth miracles are enabled by the fact that industrialization can take place in the presence of a low level of fundamental capabilities: poor economies can experience structural transformation even when skills are low and institutions weak. This process helps explains the

---

Dani Rodrik is the Rafiq Hariri Professor of International Political Economy at the John F. Kennedy School of Government, Harvard University. This summary was prepared for the Towards a Better Global Economy Project funded by the Global Citizen Foundation. The author alone is responsible for its content. Comments or questions should be directed to dani_rodrik@harvard.edu.

rapid take-off of East Asian economies in the postwar period, from Taiwan in the late 1950s to China in the late 1970s.

The policies needed to accumulate fundamental capabilities and those required to foster structural change naturally overlap, but they are distinct. The first set of policies entails a much broader range of investments in skills, education, administrative capacity, and governance; the second can take the form of narrower, targeted remedies. Without some semblance of macroeconomic stability and property rights protection, new industries cannot emerge. But a country need not attain Sweden's level of institutional quality in order to be able to compete with Swedish producers on world markets in many manufactures. Furthermore, fostering new industries often requires second-best, unconventional policies that are in tension with fundamentals. When successful, heterodox policies work precisely because they compensate for weakness in those fundamentals.

In principle, this broad recipe can continue to serve developing countries well in the future. In particular, it can allow the world's poorest countries in Africa to embark on Asian-style structural transformation and rapid growth. But a number of considerations suggest that developing countries will face stronger headwinds in the decades ahead.

First, the global economy is likely to be significantly less buoyant than in recent decades. The world's richest economies are hobbled by high levels of public debt, which typically results in low growth and defensive economic policies. The euro area is facing an existential crisis; even if Europe manages to stay together, its problems will continue to rein in the region's growth dynamism. Policy makers in these rich countries will remain preoccupied with domestic challenges, preventing them from exhibiting much global leadership.

Second, technological changes are rendering manufacturing more capital and skill intensive, reducing the employment-elasticity of industrialization and the capacity of manufacturing to absorb large volumes of unskilled labor from the countryside and the informal sector. Global supply chains may facilitate entry into manufacturing for low-cost countries that are able to attract foreign investment. But they also reduce linkages with the rest of the economy and the potential for the development of local upstream suppliers.

Other factors will also work against manufacturing industries. New entrants into standardized manufacturing activities face much greater global competition today than the Republic of Korea or Taiwan faced in the 1960s and 1970s or China faced in the 1990s. Most African manufacturers today face an onslaught of cheap imports from China and other Asian exporters, which make it difficult for them to survive on their home turf, let alone cross-subsidize their international activities. The burdens placed on government policy to incubate and develop domestic manufacturing firms are correspondingly heavier.

The framework presented shows how fundamental improvements in capabilities (defined as both skills and institutional development) and narrower policies targeted at rapid structural change (industrialization in particular) interact to produce sustainable, longer-term growth. In the long run, convergence with wealthy economies requires the accumulation of human capital and the acquisition of high-quality institutions. But the quickest way to achieve growth is to deploy policies that help build modern industries that employ an increasing share of the economy's labor resources. Policies of this type overlap with policies needed to build up fundamental capabilities, but they are not one and the same, and they often diverge significantly. An excessive focus on "fundamentals" may slow growth if it distracts policy makers from resorting to the (often unconventional) policies of structural transformation required to get modern industries off the ground. Similarly, excessive focus on industrialization may set the economy up for an eventual downfall if the requisite skills and institutions are not built up over time.

In principle, this broad recipe can continue to serve developing countries well in the future. In particular, it can allow the world's poorest countries in Africa to embark on Asian-style structural transformation and rapid growth. But a number of considerations suggest that developing countries will face stronger headwinds in the decades ahead. They include the new the global context, changes within manufacturing, increased global competition, and growing environmental concerns.

Ultimately, growth depends primarily on what happens at home. Even if the world economy provides more headwinds than tailwinds, desirable policies will continue to share features that have served successful countries well in the past. These features include a stable macroeconomic framework; incentives for economic restructuring and diversification (both market led and government provided); social policies to address inequality and exclusion; continued investments in human capital and skills; and a strengthening of regulatory, legal, and political institutions over time. Countries that do their homework along these dimensions will do better than those that do not.

Beyond these generalities, however, the main policy implication is that future growth strategies will differ in their emphasis, if not their main outlines. In particular, reliance on domestic (or in certain cases regional) markets and resources will need to substitute at the margin for reliance on foreign markets, foreign finance, and foreign investment. The upgrading of the home market will in turn necessitate greater emphasis on income distribution and the health of the middle class as part and parcel of a growth strategy. Social policy and growth strategy will become complements to a much greater extent.

Globally, it will not make sense to pursue the extensive harmonization and coordination of policies in finance and trade, which are ultimately neither sustainable nor, in view of the heterogeneity of needs and preferences around the world, desirable. International institutions will do better to accommodate the inevitable reduction of the pace of globalization (or, perhaps, some deglobalization) than to shoehorn countries into ill-fitting rules. Industrial countries will need to carve out some policy space to rework their social bargains, just as developing countries need policy space to restructure their economies. A new settlement will be needed between advanced countries and large emerging markets in which the latter no longer see themselves as free-riders on the policies of the former.

Ultimately, a healthy world economy needs to rest on healthy national economies and societies. Global rules that restrict domestic policy space too much are counterproductive insofar as they narrow the scope for growth- and equity-producing policies. They thus undermine the support for and legitimacy of an open global economy. The challenge is to design an architecture that respects the domestic priorities of individual countries while ensuring that major cross-border spillovers and global public goods are addressed.