
Country Note 1

Economic Growth from the *Very* Long-Term Perspective of History

To economists, the reasons for countries' growth performance lie in the incentives created by policies and institutions. Typically, economists examine questions such as the following: Does taxation discourage savings and investment? Are a country's public institutions capable of enforcing property rights and delivering public goods? Does the trade regime facilitate integration in the global economy? Does the private sector have sufficient confidence in the future direction of policies? Are fiscal policies consistent with the long-run solvency of the public sector? Underlying these questions is the goal of ascertaining whether the country has enough incentives to use existing resources and to accumulate capital—factors that ultimately determine growth performance.

On the other hand, since the early writings of Montesquieu, Karl Marx, and Max Weber, social scientists and economic historians have sought to uncover the deep underlying reasons for the wealth and poverty of nations. From their perspective, economic growth is deeply rooted in a country's history and structural conditions, which shape societies' choices and ultimately the policies and institutions they adopt. In this context, they seek to address questions such as the following: Was there something special about Western Europe that made it the birthplace of the Industrial Revolution, notwithstanding the earlier and superior scientific and technological achievements of China and the Arab world, and Asia's superior agricultural productivity? Something that was absent elsewhere, in the Americas, Africa, or Asia? Why did India's economy stagnate for so long, despite its enormous natural

wealth and human skills that until the 1700s were superior to Europe's? Analyzing long-run growth implies analyzing complex historical and political processes. Scholars have proposed numerous hypotheses to uncover the "deep" exogenous forces at work. Three of these forces have received the most attention in economic research: geography, openness to foreign trade, and institutions.

Since Montesquieu, authors have periodically considered geography as a "deep," truly exogenous factor explaining economic performance. There are many channels through which physical geography affects growth: a country's geography shapes its natural-resource endowments (oil, minerals, diamonds) and public health environment (disease burden), and limits or enhances agricultural productivity (quality of soils, amount of rainfall). A striking one-third of the world's gross domestic product (GDP) is produced in the temperate ecological zones within 100 km of the world's navigable waterways; these zones amount to only 4 percent of the world's landmass. Almost none of the industrialized countries are in the tropics or subtropics, or landlocked (Gallup, Sachs, and Mellinger 1999).

In an authoritative study on the long-run geographic determinants of development, social ecologist Jared Diamond (1997) argues that Eurasia had large geographical advantages over the Americas and Africa, and that these lie at the heart of current income disparities. He argues that since plant and animal species spread most effectively within ecological zones, the east-west orientation of the Eurasian landmass made it easier to diffuse early human technologies across the continent. As a result, Eurasia enjoyed a larger diversity of plant and

animal species, and thus easier domestication of useful species, than did societies in America and Africa—continents that are oriented north-south. High-productivity agriculture led to large, dense, stratified societies, with subsequent advances in technology (weaponry, oceangoing ships) and political organization.

Another important causal factor widely studied in economic history is international trade, and hence access to sea-based trade and proximity to export markets. Economists since Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* have argued that foreign trade helps economic growth because it encourages the division of labor and specialization, the locomotives of human development throughout history. Numerous empirical studies have shown that openness and growth proceed "hand-in-hand" (Balassa 1978; Sachs and Warner 1995; Ben-David 1993; Krueger 1997; Frankel and Rose 1999). Historically, two remarkable examples of early industrialization are the island nations of Britain and Japan, one being the cradle of the industrial revolution, and the other the only successful industrialization in Asia until the second half of the 20th century.

Finally, recent analyses of long-term economic growth emphasize the crucial role played by institutions, that is, the formal and informal rules and norms that govern personal and social behavior; including the socioeconomic arrangements that constrain predation by the state and individuals (North 1990). Institutions were a central focus of attention for the Latin American Structuralist school in the 1950s and 1960s; but today they are seen by some as the most significant factor in long-term development. Recent econometric and case studies have shown that even when controlling for historical endogeneity, institutions remain "deep" causal factors, while openness and geography operates at best through them (Acemoglu, Johnson, and Robinson 2001; Rodrik 2003b; Rodrik, Subramanian, and Trebbi 2002).

Of course, hypotheses explaining economic growth are difficult to verify empirically. Countries are not amenable to controlled experiments, and, in

reality, complex relationships are at work among geography, institutions, and trade. Each factor can potentially reveal valuable insights about the true causes of countries' development successes and failures. For instance, Western Europe benefited both from the geographical advantages of east-west continental orientation discussed by Diamond (1997), and from being predominantly a coastal region in the temperate ecozone (Gallup, Sachs, and Mellinger 1999). All of this made land scarce and valuable (Herbst 2000). Additionally, rugged mountainous relief effectively separated Western Europe into a system of "competing jurisdictions of decentralized power," constantly warring with one another, none being able to completely defeat and control the others (Landes 1998). These factors raised returns to innovation, discovery, and adoption of new warfare techniques, which later gave Europeans first-mover advantage over other parts of the world.

Another perspective on the "European economic miracle" (Jones 1981) emphasizes the key role of risk, uncertainty, and predation in the formation of European socioeconomic and political institutions, issues that have long been familiar to economists. Two fundamental forces were at work. First, the distribution of income in Europe was unusually equal relative to, for instance, Asia. "Late Manchu China with a population of some 400 million supported a two percent of the population elite which consumed in the late 1800 one fourth of the national product. Whereas a relatively large share of the population of Europe had risen above subsistence level before the Industrial Revolution, the vast majority of the population in China, Northern India, Mesopotamia and Egypt hovered slightly above or below the threshold of survival." Smaller inequalities allowed for a social environment able to keep in check predation by both individuals as well as organized groups, including the state. "Europe alone managed the politically remarkable feat of curtailing arbitrary power, thus reducing risk and uncertainty, encouraging more productive investment, and promoting growth." Second, in Europe's natural environment, adverse shocks (in the form of floods, earthquakes, epidemics) were less

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common than in, for example, China or India and contributed to reduce the uncertainty associated with investment decisions, thereby increasing the incentives for individuals and firms to invest and take risks (Jones 1981).

Economic development is deeply embedded in countries' history and structural conditions, and

understanding these is essential for the design of effective growth strategies. The rest of this report highlights the widely differing strategies adopted by successful countries, and that the art of formulating effective growth strategies lies in careful consideration of country-specific factors, opportunities, and constraints.