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Book Review

The Quest for Prosperity: How Developing Economies Can Take Off[1]

Justin Yifu Lin (2012)

The inherited tragedy of depressing living standards across the globe contracted since the Industrial Revolution introduced phenomenal living standards into Western economies. This stark tragedy, however, still survives across most of the world's countries making economic convergence one of the most formidable challenges in economic policy. The Quest for Prosperity by Lin is a vigorous attempt to introduce new structural economics. It plainly deciphers the failure of developing economies in materializing their dream of economic prosperity. Lin, the first from the developing world to run the World Bank's affairs as chief economist, meticulously appraises structural economics since its emergence and explains the paramount significance of comparative advantage in determining economic strength. The book offers reasoned thought on why few nations from the low-income world, having chosen their own course instead to follow the prevailing development thinking, achieved the elevated status of developed economies.

In the opening literature of the book, we receive little discussion on the prevailing global financial crisis. Lin maintains that the origin of the crisis, though, pertains to financial sector but the real challenge is real sector revival. In advanced economies, conventional fiscal and monetary policies are vain instruments in the presence of excess capacity and instead, large scale, global productivity, infrastructure programs can create required demand to absorb excess capacity and potential space for structural reforms. In the author's opinion, such modus-operandi is beyond Keynesianism. The key element of demand creation in suggested policy, however, is identical to Keynes' policy stance. Moreover, we are missing the author's views on the potency of contemporary monetary policy instruments: asset purchasing and forward-guidance.

The intellectual dexterity to weave an opening discussion on the financial crisis into growth divergence and poverty, without slightly distracting the reader's concentration, is commendable. Lin brings us the discussion on growth process while pointing out that income convergence remains quite disappointing across the globe. The prevailing income divergence, at an astonishingly wide-scale, clearly indicates the Achilles' heel of the proposed growth theories in failing to ignore such factors that determine convergence ability. The successful transformation of developing states into advanced ones reveals their ability to

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alter human and physical capital endowments, adaptability to new ideas, pacing industrial upgrading and improving soft (institutions) as well as hard infrastructure (transportation and telecommunication networks).

Lin, with impressive articulation, takes us back to the 1940s in introducing the emergence of structuralism that asserted the role of government in supporting the modernization process at the large scale. The academic defense, to support a potent state's intervention in achieving advanced living standards, was based on perceived market failures in developing economies on account of low saving, low investment and high population. The second wave in structural theory appeared in the mid-1950s lasting until the late 1960s. The relevance of the second wave is linked with the invention of 'imports substitution policy'. The developing world can only overcome growth-pressing limits with a strategy of imports substitution as relying on exports would meet the outcome of unfavorable terms of trade (TOT) due to inelastic world demand for commodities; as argued by latecomers. The motivation behind structural policy work, according to Lin, stemmed from Keynes's policy advice, Soviet Union State planning and emerging national governments having determined to modernize their newly independent nations.

The book, besides academic discussion on structural doctrine, accelerates excitement to know the upshot of policy practices centered on structural approach. Pursuing economic prosperity through government intervention to initiate modernization process at large scale and embracing ideology of imports substitution met with complete failure in Africa, Latin America and South Asia. Here emerged Washington Consensus advocating market-oriented reforms and refuting a theoretical foundation of a governmental role in up-lifting living standards. The birth of the Washington Consensus approach was based on the ebbing influence of Keynes's economics against stagflation of the 1970s, Latin America debt crisis and collapse of the Soviet State System in the 1980s. This approach too, failed on its promises.

What explains the failure of countries (Ghana, China, Indonesia, India, Egypt, Peru, Senegal, etc.) that exercised aggressive government intervention in building modern industries and pursued the policy of imports substitution vigorously? The strength of the answer to this mighty question reflects Lin's intellectual depth in understanding the low-income world and bringing powerful analysis of development policy and practice. Ambitious attempts in the quest of prosperity met with failures because capital-intensive projects were completely inconsistent with the comparative advantage of developing economies. Factors endowment (natural resources and labor abundance) primarily explain the economic strength of developing world. Launching modernization process at wide scale without altering the economic strength required to support industrialization yields only disappointing results. Firms' viability (able to earn profit without external support in open competition), as the author asserts, is fundamental in transforming an economy into a high-income level. In failure cases, firms built with government support were not viable due to inconsistent endowment structure, hence neither competed well in the international market nor on the domestic front. In order to make them competitive, governments continued to protect capital intensive industries with heavy subsidies which ultimately drained government resources as firms' profitability could never materialize. Once resources ran out, firms relying on them collapsed adding economic misery and eating up growth: quite opposed to what industrialization meant to achieve. This is the reason that well-intentioned national efforts failed as goals were not affordable with different economic strengths. Comparative advantage, on the other hand, explains the success of a few other nations that adopted exports promotion strategy instead of imports substitution. Exploiting comparative advantage, successful nations were able to alter their human and physical resources, preparing gradually for industrialized challenges.

The book, however, does not explain how achievers avoided prevailing development thoughts especially when other developing countries were taking them in their national strategies. Unlike China, which did not succumb to another flawed theory of the Washington Consensus and instead rose to become a global economic power, brings compelling question for the rest of the economies; those which kept practicing one flawed theory after another.

We clearly realize, with almost every turned page, that Lin's most powerful argument to introduce new structural economics is tight around comparative advantage. Factors endowment determines comparative advantage and transformation from labor/resource intensive to capital intensive structure requires a change in factor endowments composition. Choosing industries, aligned with comparative advantage, allows countries to accumulate capital through economic surplus; the only way to gradually elevate industrial strength. New structural economics, the author acknowledges, recognize the significance of imports substitution for the developing world as long as it is consistent with the shift in comparative advantage. It does not oppose, either, free market approach, and instead believes it to be the essential mechanism to determine relative factors prices which in turn reflect comparative advantage. The free market approach, moreover, must not abandon government assistance in industrial upgrading. The author's comfort with imports substitution strategy along shifting comparative advantage is questionable. How a developing country can afford to run both strategies in parallel with scarce resources; a natural question that demands necessary explanation?

How to identify the comparative advantage if it is not apparent is a big question. The book, on this account, is not a frustration at all. Countries can determine comparative advantage by analyzing the performance of tradable industries that, with similar endowment structure, have shown fast growth with relatively better income in recent decades. The book outlines comprehensive strategies to discover comparative advantage with respect to the nature of endowment resources (labor/ resource intensive). The author's logical framework suggests that in a first step, developing countries need to identify the right industries reflecting comparative advantage and then government facilitation must be materialized in establishing required infrastructure and fixing coordination issues.

Finally, in contrast to the exhausting chapters of the book, reading energy springs-up on account of the elevated focus on the middle-income trap dilemma. What explains income stagnancy is failure to identify comparative advantage at the changing development stage that can empower economic fundamentals to generate high living standards. When countries stop discovering latent economic strength, the author powerfully argues, industrial upgrading remains out of the question leading freely to embracing the middle-income trap. We do not feel left hanging in theoretical discussion but rather the book presents classically practical country cases compatible to the arguments in defense of new structural economics. Ireland, for instance, remained an middle-income country until the late 1970s for the same reason and what enabled it to break the middle-income trap was its ability to identify new comparative advantage and the government's facilitation in industrial upgrading.

The quest for prosperity, therefore, demands a perpetual pursuit in order to identify the right comparative advantage and potent role of the state in providing sound infrastructure to make exports internationally competitive. And this is how countries achieved prosperity. Moreover, at all income levels, continuous industrial upgrading is the only policy option to ensure high living standards. What remains absent from the book are clearly mentioned limitations of the proposed new approach to structural economics.

Lin's work is practical and a great choice to read for everyone who yearns to cultivate meticulously a clear understanding about what works in development thinking.