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Truth is the Safest Lie

A Reassessment of Development Economics

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1 | Sins, Blame, and Redemption

Ghanaians pride themselves for being the first African country to reclaim its independence from colonialists. The pride and the boasting have reached new heights this year, as they celebrate the sixtieth year of their freedom. But behind the chanting, dancing, talking, and conferencing, the question often discussed mezza voce is the true length of the road traveled since then, and the size and value of the dividends of freedom. Many Ghanaians in the poor slums of Accra and Kumasi, and in the miserable rural areas of the country, are blaming their political leaders of the past six decades for being mainly sinners who should be held responsible for their plight. They don't think that independence has yielded its promise. In fact, it is an appropriate moment for Ghanaian, African leaders, and development economists to step aside from the dancing and the chanting to reflect on progress—and on what went wrong in the quest for prosperity, not just in this country, but throughout the developing world. And perhaps to seek redemption.

Back in 1957 when Osagyefo Kwame Nkrumah successfully led Ghana's quest for independence, I was not yet born but I know from reading history books that this country was expected to quickly become the beacon of hope for the continent and for the Third World. There was a lot of excitement. Since then, Ghana has gone through its ups and downs but has mostly underachieved—like most countries elegantly branded as "developing." Nkrumah seemed to have all that was needed to convert freedom into collective welfare for his people: he had the vision, the passion, the inner strength, the popular support, and the basic wit. He even recruited as one of his senior advisors, Sir Arthur Lewis, one of the greatest economic minds of the time and to this day, and the only Black person to ever win the Nobel Prize in economics.

Yet, great economic thinking did not seem to help policy-making. Six decades after independence and despite experimenting with almost all types of modern forms of government and the rebasing and the statistical revisions of gross domestic product, Nkrumah's country still is not doing very well. Growth has been insufficient to reduce poverty, and most of the labor force—whether highly skilled or not—is still underemployed in not unemployed.

What happened?

Like many developing country leaders since independence, Nkrumah was a bright young man, well educated, and a true hero to his people. But he lacked some basic wisdom—which manifests itself in the humble search for the truth and the willingness to ignore ideological jargon and focus instead on economic theories and policy practices that provide undisputable, quick and sustainable results. Compare Nkrumah to Deng Xiaoping or Lee Kuan Yew, who rose to the challenge of leadership and presided over successful experiments in politically difficult circumstances. What did they know that Nkrumah di not? What can we learn from their stories?

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It would be unfair to pick on Ghana. In fact, Ghana's story has largely been Africa's story, and that of many other developing countries. I will argue in this think piece that Ghana's failure to rise to its potential and achieve its goals has mainly been the failure not of politics, the weakness of institutions, or the lack of initial conditions, but the failure of economic thinking and policymaking. Therefore, I believe that the failure of development was not—and still is not—caused by insufficient human capital, by inadequate access to finance, or by such popular notions as infrastructure deficits or corruption. These factors made matters worse but they are consequences of bad initial strategic choices. But they are not the causes of the problem.

I will also argue that Ghana's failures and developing countries' failures may reflect poor leadership but not in the traditional, popular and vague sense. Few political leaders ascend to power and devote their efforts to destroying their country or impoverishing their people. In fact, politicians everywhere often have the same utility function: when their political regime is secure, safe and stable—as Nkrumah's was in 1957—they are typically interested in staying in power as long as they can, and in having a good name in history after they are gone. This is true in democratic and autocratic regimes. Barring some extremist and crazy characters, they all have these same basic motivations. The major difference among political leaders across political systems is indeed their leadership ability, but leadership defined more narrowly as the capacity and willingness to articulate bold but credible visions, choose good economic advisers, and lead teams that can implement plans with discipline and humility to achieve results rapidly—while correcting the unavoidable mistakes along the way.

Most African politicians have, on average, been bad leaders. But the failure of economic development is primarily due to the pervasiveness of bad ideas, which translate into bad advice by influential economists—those in the position to shape or influence policymaking. Poverty and underemployment in Africa today (at a time when resources of all kinds and opportunities have never been so numerous and so cheaply available everywhere) primarily reflect the imagination deficit among development economists—not the incompetence of politicians. After all, politicians everywhere do what they are supposed to: politics, a selfish and often dreadful sport.

It is the responsibility of economists to put great ideas on the table and find ways to positively influence the public discourse and the policies that are implemented. Retreating to their ivory towers, and complaining that political leaders do not solicit their wisdom and knowledge, is an easy escape route. It does not absolve them from their duty as elites, intellectuals, social leaders, and minority members of a community in which they represent what W.E.B. Du Bois called "the talented tenth." They do not seem to fully grasp the burden of the responsibility that comes with being highly educated in a society that craves for knowledge and learning.

To repeat: What exactly happened to Ghana and to other African and developing countries? In my view, two basic dynamics negatively reinforced each other over decades. First, national leaders gained political power, often in unconventional ways, and spent most of their energy either trying to replicate the governance models from colonial times, or to imitate policy frameworks in vogue in advanced countries but inappropriate for theirs. Then, they quickly ended up succumbing to the intoxicating luster of authority and struggling to maintain their grip on the levers of state political and financial power. Many of them failed to understand that the most effective way to remain at the top and retain control was to deliver quick, tangible results, and to improve the lives of their people. Most of the time, they consistently picked and implemented bad ideas, often from well-meaning economists and development experts.

The combination of the two processes gradually made things worse and worse. The main results were economic failures, massive unemployment, poverty, despair, distorted belief systems, social and political chaos, and the generalization of witchcraft.

Frustrated by the course of events, many good economists gave up—in fact, the field of development economics was pushed to the fringes of the discipline for much of the sixties and seventies. Others opted for intellectual laziness, spending their time in intellectual mimicry, and simply transferring whatever concepts or theories were in fashion in Latin America and Asia to their analyses of African countries. It is not surprising that a lot of development economics has been dominated by the identification of the sins committed and the search for who is to blame.

The good news is that time has gone by. Lessons have been learned. Spectacular successes such as the rise of China, Taiwan-China, Singapore, South Korea, Dubai, and the United Arab Emirates, and unfolding ongoing successes in Mauritius, or Vietnam, have shed light on what should be done or avoided. Despite many failed experiments, economic history now provides enough good stories that do not have to be copied but that can certainly inspire both researchers and policymakers. There are possibilities of redemption for political leaders and development economists in Ghana and elsewhere.

This note summarizes some of the key elements of the knowledge accumulated in development economics. It is obviously biased toward my own work with Justin Yifu Lin (under the label New Structural Economics), and Joseph Stiglitz (on the rethinking of industrial policy)—a selected reading list is provided in the references. Section 2 challenges the dominant paradigms of development thinking, from a fundamental, philosophical perspective. Section 3 sums up the key recommendations for a more appropriate approach. Section 4 offers concluding thoughts.

2 | Economics as a Prayer: A Critique

Years ago, while studying in Boston, I asked Robert Solow why many great economists like him had stayed away from African issues. I was trying to provoke him because the truth is that many great economic minds had worked on Africa. In his typical direct style, Solow responded that he avoided

development economics simply because it was "too hard! Most of my colleagues who ventured in that area did not do too well." He also explained that the kind of macroeconomics he did would apply only in socioeconomic and political environments where the institutions required to make it work were already in place. He felt that developing countries were intrinsically different from advanced economies.

In 2008 while an economist at the World Bank, I tried to convince Olivier Blanchard, then the chair of the Economics department at MIT, to express interest in the World Bank Chief Economist position, which had just become vacant. I felt that his stellar intellectual contributions to the analysis of employment, unemployment, and labor market issues would bring them to the center of the global agenda. I always believed that the job creation should be at the core of our poverty reduction strategies. Olivier's response was swift and clear: "I think I know a bit about macroeconomics, but I know very little if anything about economic development. I certainly would not qualify for that job."

Later, after he became the chief Economist of the IMF, I asked how he felt about the research his institution was doing on Africa. He praised his team but told me very candidly that he was not satisfied with some of the analytical tools used for policy analysis and simulations on low-income countries. He indicated that some of the work was too often small variations from dynamic stochastic general equilibrium models designed for industrialized economies. The day we discussed this, he had just reviewed the econometric model for Togo and could tell that the assumptions about the functioning of the labor market there were probably inappropriate for a low-income African country. He also expressed frustration at not being able to provide a suitable econometric model for effective policymaking in Togo.

Beyond their remarkable humility and their refusal to venture outside their field of expertise, Solow and Blanchard were highlighting one of the biggest intellectual problems in development economics: The disconnect between high-income and low-income economies, and the refusal of some economists to acknowledge the structural differences that this implies or to draw the analytical implications from that central fact. Solow and Blanchard intuitively recognized that Burundi is not Switzerland even though both are small and landlocked, and that Madagascar is not Japan, even though both are sea-locked.

Structure matters. Neglecting that intrinsic truth has been the biggest of all analytical sins by development economists. That sin has led to two major strategic mistakes, which in turn have invalidated much of the excellent work done since the emergence of development economics as a subdiscipline of economics after World War II. First, in thinking about convergence and the task of transforming low-income countries into industrialized economies, we have too often selected the wrong comparators and benchmarks, and set the wrong objectives for our work—and obviously that of the policymakers who follow our advice. The wrong choice of model economies has led many theoreticians and empiricists to adopt some profoundly misleading assumptions that no sensitivity analyses could correct. Second, these compounding mistakes have generated a false economics of preconditions, and the wrong policy prescriptions. Let me briefly discuss these two mistakes in turn.

The wrong model economy and reference

It is obviously legitimate for Burundi to try to be like Switzerland, and there is indeed no reason for the many hardworking citizens of Bujumbura to expect to live the supposedly good life of the not so hardworking people of Zurich. But even leaving aside history, the current endowment structures of two economies are so different that it would not make much analytical sense to study them with the same tools and to derive policy recommendations from similar econometric models. It is legitimate for political leaders in Burundi to try to emulate the success of others in advanced economies. It is strange for economists to rigidly and mechanically apply methods and tools designed for capital-intensive Switzerland to capital-poor, labor-intensive Burundi. It has been reported that Nkrumah wanted the Ghanaian economy to surpass that of England almost the day after independence. A noble political goal perhaps, but a foolish predicament for economic policy. The model economy that Burundi 2017 or Ghana 2017 may want to "emulate" should not be Switzerland 2017 or the United Kingdom 2017 but, perhaps, Mauritius 1974. There is a sequencing of strategies that low-income economies ignore only at their own peril.

Let me stress one point: I am not advocating a teleological view of economic development. Of course, one can move faster from one step to the other, and Walt Rostow was wrong in suggesting that there is an almost linear process with a rigid timing in the various "stages of economic development." The acceleration of economic history is the evidence that he was wrong. Prior to the 18th century, it took 1,400 years to double income in the Western world. In the 19th century, it took only about 70 years. In the 20th century, it required only about 35 years. The changing pace of performance among individual countries is even more encouraging. It took 150 years for Great Britain to initially double its income. The United States needed 50 years to do the same. And without the natural resources, excellent infrastructure, or human capital of Britain, the US, or the Scandinavian countries, China did it in just 12 years.

Some economists draw the wrong inference from these facts: they mistakenly conclude that low-income economies can achieve prosperity without developing manufacturing, by just launching high-value added industries or encouraging the emergence of tradable services. Such strategies, which violate comparative advantage, would not be sustainable. Trying to develop sophisticated, capital-intensive industries and services in a $500 per capita economy whose comparative advantage is still in labor-intensive industries is the problem: with a labor force of some 600 million people, most of them low-skilled workers, Africa puts less than 20 percent of its labor force in the formal sector.

The lesson here is not that poor economies should try to circumvent the steps of industrialization and jump from low-

productivity agriculture to high-tech industries and services when they are capital-scarce and have poor business environments. Instead, they should try to put the largest possible fractions of their labor force to work by developing industries that are consistent with their existing (and changeable) comparative advantage. The dynamics of more people working in the formal sector, earning gradually decent incomes and developing soft skills and their human capital, eventually moves the economy into more sophisticated, high-value-added industries and sectors. Of course, good public policies can help speed up the evolution of an economy's endowment structure and compress the timing of structural transformation.

Unfortunately, some development economists continue to neglect the need for industrial upgrading in low-income countries. They still advocate benchmarking poor economies, with high-income economies as the model to emulate. That has been a recipe for disappointment for a long time.

The wrong assumptions and preconditions

Choosing the wrong model or reference economy to copy carries some heavy implications and leads to risky optical errors. Instead of seeing the resources already in place in each poor country and focusing the intellectual and policy resources to maximizing the existing assets and building on successes to accelerate reforms, one focuses only on the missing ingredients for growth and prosperity, and quickly becomes obsessed with the lengthy list of preconditions to be fulfilled—before the growth process can be ignited. This is a disturbing trend, and a counter-productive intellectual attitude.

That mindset of "missing elements" and "gaps" has translated into a peculiar intellectual posture: economists have confined themselves to the role of detectives, if not prosecutors. Without fully realizing it, many development experts behave like detectives in Arthur Conan Doyle and Agatha Christie novels. They have converted themselves into a Sherlock Holmes or Hercule Poirot whose divine mission is to find what is wrong with low-income countries, not what may be right and sufficient there to start something good. The "gap" mentality among researchers has therefore stimulated the emergence of a dominant brand of development policy that is basically an obsessive (if not compulsive) quest to correct the "deficiencies." Of course, the search has produced long lists of true or false deficiencies, real or imaginary gaps, and truly missing or illusory ingredients for development recipes, which are presented as necessary conditions for economic progress. But the whole exercise has not paid off. Indeed, the search has created more problems for economists and policymakers than it has brought solutions. Instead of focusing on what each country—even the poorest—already has to build a viable development strategy, the compulsive search for the missing gap has validated and legitimized the notion that little can be done in poor countries unless they meet a long list of preconditions. Instead of adopting the mindset of how to maximize whatever few production factors are in place, development economists have too often devoted their energy and creativity to what must be done as preconditions for growth and prosperity. Instead of looking at the glass as half full, they have consistently seen it as almost completely empty.

Yet, we know from the history of development that no single successful economy in the world started out with ideal country conditions. Successful development processes always emerge from average if not very poor institutional and policy environments. Neither the United States nor Great Britain had "excellent" infrastructure stocks prior to the Industrial Revolution, or even in the years and decades after that. China did not have "adequate" levels of human capital when Deng Xiaoping launched the shocking economic journey of growing the economy by nearly 10 percent a year for three decades and lifting some 600 million people out of poverty.

By succumbing to the Sherlock Holmes syndrome, some researchers miss what should be the focus of economic policy in low-income countries—and that is structural transformation, the transfer of human resources and capital to the most productive activities. This may be because many of us limited the development agenda to the Washington Consensus policies, mainly designed to address macroeconomic imbalances that developing countries experienced in the 1980s. Macro stabilization and structural reforms were necessary but not sufficient conditions for prosperity. They were not necessarily recipes for creating employment. Rwanda President Paul Kagame has declared that his country scores among the top-performers in almost all categories of the Doing Business Indicators but has not created enough employment in the formal sector. That is true: his country has done remarkably well in improving the business environment, but it must still do even more to generate the kind of good labor-intensive industries that will eventually bring prosperity to the people.

Another issue not always carefully studied is good governance. We all know how important that is and can see the correlation with GDP per capita in cross-country regressions. But we need to dig deeper, define it more precisely in our research, and customize what "good institutions" might look like in different country contexts. Let me just give one example to illustrate the point. Late Presidents Félix Houphouët-Boigny and Julius Nyerere are among the most admired in recent African political history. Yet, the former—who once said at a press conference that any "serious individual" should have a Swiss bank account and urged people not to dwell on high levels of corruption in Côte d'Ivoire—was able to propel his country on a long path of high growth. Compare his development performance with that of President Nyerere, widely perceived as a near saint for running arguably the least corrupt African government of the post-independence era, who apologized for failing his people with low growth and high poverty. Clearly, poor governance is a grave issue to be tacked energetically. But even as this is still under way, smart growth strategies can be implemented and yield satisfactory results.

Development thinking should aim at providing more actionable sets of policies to political leaders, and avoid offering laundry lists of reforms that are politically difficult to implement and may not immediately yield the intended results. Leaving economic

development to the market is taking a bet on what I call the painful economics of chance, approaching economics as a prayer that may or may not be answered. Different industries require distinct types of infrastructure. And since low-income country governments do not have the financial resources to accommodate all industries at once, it is best to work with the private sector to identify industries where the economy has a comparative advantage, and to focus on providing specific infrastructure and transparent, limited incentives that would allow these industries to grow.

Look at the list of recent success stories in Africa to understand the role of industrial policies. Textiles in Mauritius, apparel in Lesotho, cotton in Burkina Faso, cut flowers in Ethiopia, mangos in Mali, and gorilla tourism in Rwanda all required that governments provide different types of infrastructure. The refrigeration facilities needed at the airport and the regular flights to ship Ethiopia's cut flowers to the auctions in Europe are obviously quite different from the improvements required at the port facilities for textile exports in Mauritius. Similarly, the type of infrastructure for the garment industry in Lesotho is distinct from the one for mango production and export in Mali or for attracting gorilla tourism in Rwanda. Because fiscal resources and implementation capacity are limited, the government in each of those countries had to prioritize and decide which specific infrastructure they should improve or where to optimally locate the public services to make those success stories happen.

3 | Enriching and Strengthening Development Thinking

Where do we go from here? Well, back to the basics. If we believe the long-run statistics put together by Angus Maddison, we must accept that for 1,400 years of economic history all countries in all regions of the world were low income. Then the Industrial Revolution separated regions and countries. The divergence did not happen by chance: clever ideas generated prosperity in some places while bad ideas took hold in others. If we have learned anything since the Industrial Revolution, it is the basic truth that modern economic growth is a process of industrial, technological, and institutional upgrading that reflects the changing dynamics of comparative advantage and endowment structure. Ignoring it leads to policy prescriptions that defy the laws of economics and inevitably to disappointments, and to what Ernest Aryeetey has called "negative diversification" (moving labor from low-productivity, subsistence agriculture, to low-productivity, informal services).

The challenge to development economists is to continue building richer and more credible economic models that also offer policymakers clearer road maps for implementing a key principle of the discipline: allocating scarce resources to industries, sectors, and geographical areas with the highest possible payoffs. Inevitably, this would imply being more rigorous in selecting where to put the money and other resources, and being more thoughtful in targeting reform efforts. As Ricardo Hausman, Dani Rodrik, and Andres Velasco have shown, not all binding constraints are equal—or deserve the same amount of attention from high-level policymakers.

The very words "selection" and "targeting" tend to immediately raise concerns about "industrial policies" by activist governments. So, let me clarify what I have in mind. All governments are "activist" in one sense or the other. The question is whether their "activism" is devoted to creating the optimal conditions for agents to strive, and to addressing coordination and externalities that prevent the private sector from flourishing and generating jobs.

All governments in the world are constantly engaged in various forms of industrial policies—they take actions that favor certain industries more than others and therefore shape sector allocations in the economy. In all countries, some industries, sectors, and even firms are favored within the legal framework and often heavily subsidized, often in opaque ways. Bankruptcy laws that put derivatives first in line in the event of bankruptcy effectively give preference to the financial sector. Most countries' tax codes are riddled with tax expenditures that provide hidden subsidies to some industries. But even in the absence of such "special" provisions, the design of depreciation allowances will affect industries with different capital lifespans differently. Budget policies also inevitably have impacts on industrial structure: where governments locate roads and ports affects different industries and firms differently. In short, one cannot escape thinking about the different impacts of different policies on different sectors.

True, the record of most activist governments is mixed. Critics of the industrial policies in many African countries just after independence argue that they introduced profound distortions: they used limited public resources to pursue unsustainable import-substitution policies. To reduce the burden of public subsidies, governments sometimes resorted to administrative measures—granting the nonviable enterprises in priority industries a market monopoly, suppressing interest rates, overvaluing domestic currency, and controlling prices for raw materials. Such interventions introduced further distortions, sometimes even causing shortages in foreign exchange and raw materials. Preferential access to credit deprived others of resources. There was a high opportunity cost. While industrial policies were often blamed for these disappointing outcomes, failures in macro-economic policies and governance often played a role—and often were the real source of the problem.

The standard argument was that markets were efficient, so there was no need for government to intervene either in the sector allocation of resources or in the choices of technique. And even if markets were not efficient, governments were not likely to improve matters. But the 2008–2009 global crisis has shown that markets are not necessarily efficient. Indeed, there was a broad consensus that without strong government intervention—which included lifelines to certain firms and certain industries—the market economies of the United States and Europe may have collapsed. It is a mistake to trust

markets blindly. Some of the most important national and global policy objectives (such as equality of opportunity for all citizens, pollution control, and climate change) are simply not reflected in market prices.

Even economists who oppose sectoral industrial policy (the "vertical" policies to support specific industries) acknowledge the need for broad, neutral, "horizontal" industrial policy (one that does not target specific industries). Yet the lines between the two can be blurry. Everything governments do or choose not to do benefits or can be captured by vested interests. An exchange rate policy could be presented as "neutral" and "broad-based." Yet, we know that some sectors, industries, social groups, and even regions are always favored or penalized by any stance on the exchange rate. Even when there is no change, some benefit while others lose.

Likewise, infrastructure development is often presented as a suitable tool of economic policy because of its perceived "neutrality." Yet there is nothing neutral about the choice of infrastructure that a country needs at any given time, or where and when it should be built. These decisions always involve some political judgment about priorities, and therefore represent industrial policies. The same is true for education, which often is mistakenly presented as "neutral." Therefore, the question is not whether any government should engage in industrial policy—it is how to do it right.

All governments in the world, regardless of their politics, engage in industrial policies every single day. In fact, the entire budget exercise—which consists of submitting to parliament a law that grants different tax rates and different programs, projects, and expenditure levels to different industries, sectors, and regions—is itself industrial policy.

In sum, the intellectual challenge for development economists is not to engage in semantic debates about what industrial policy is. It is to come up with better guiding principles on how "best" any society should move its human, capital, and financial resources out of subsistence sectors. For the process to be efficient, coordination issues and externality issues must be addressed. Markets typically do not manage such structural transformations on their own well. And governments must play no more but no less of their facilitating role in the process.

A general rule may be to encourage only industries in which the economy has a clear comparative advantage—and the private sector usually identifies these industries and sector easily. When that is done, the government can come in and help foster learning among firms, within firms, and with the economy. Solow's work helped us understand how most increases in standard of living are related to the acquisition of knowledge, to "learning." Most increases in per capita income arise from advances in technology—about 70 percent of growth comes from sources other than factor accumulation. In developing countries, a substantial part of growth arises from closing the technology (or knowledge) gap with those at the frontier. And within any country, there is enormous scope for productivity improvement simply by closing the gap between best practices and average practices. If improvements in standards of living come mainly from diffusing knowledge, learning strategies must be at the heart of the development strategies.

4 | Concluding Thoughts: Promised Lands Ahead

Surveys of students in economics departments around the world still indicate that the subdiscipline of development is not a preferred field for young researchers. No one can blame them: the quest for prosperity has so far been a difficult and frustrating academic endeavor. Yet, it is in my view the most exciting area of research—as noted by Robert Lucas in his famous 1988 paper on the mechanics of economic development.

Development economics is also a high-risk, high-reward domain. Joseph Stiglitz said in his Nobel Prize lecture that his thinking about the economics of information started when he was working in the 1960s in Nairobi, Kenya. Several other future Nobel Prize laureates were there at the same time: James Tobin and Peter Diamond. Many other very successful and influential economists—such as Gary Fields and John Harris—also started their careers in Nairobi. Africa has attracted in recent years many of the best minds in the business—from Roger Myerson (another Nobel laureate) to Timothy Besley, Paul Collier, Lord Nicholas Stern, Dani Rodrik, Kaushik Basu, Justin Yifu Lin, and many others.

Perhaps Robert Solow was too pessimistic: there is a promised land for economists working on Africa and other developing areas. I can even foresee a few Nobel Prize winners in this field in the next decade. We have recently completed the two-volume, 90-chapter Oxford Handbook of Africa and Economics, which features their work and highlights some the insights that the study of Africa brings to economic science. The World Bank's research department has released a World Development Report on "Minds and Culture," which takes behavioral economics to new heights and shows how some of the findings in the African context can enlighten our understanding of economic development. My exhortation to all economists interested in development is never to abandon the arduous work it entails. In fact, for all economists in the world, Africa is the intellectual deal of the century (to paraphrase a recent statement by African Development Bank President Akinwumi Adesina). There are many jackpots to be won there if one remembers the words of civil rights leader John Lewis: "Don't give up, don't give in, don't give out!" Yes, there is a promised land ahead.

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