Journal of International and Global Studies

Volume 1 | Number 2 Article 13

4-1-2010

Dani Rodrik. One Economics, Many Recipes: Globalization, Institutions and Economic Growth. Princeton, NJ: Princeton University Press, 2007.

Mukti Upadhyay Ph.D.
Eastern Illinois University, mpupadhyay@eiu.edu

Dani Rodrik. *One Economics, Many Recipes: Globalization, Institutions and Economic Growth*. Princeton, NJ: Princeton University Press, 2007.

Dani Rodrik's book *One Economics, Many Recipes* is an admirable piece of work on development economics. The first time I saw the book, I thought its title might be woefully unrepresentative of whatever Rodrik, the development economist, might say. The book could be about any branch of economics, or it could perhaps be an exploration of the discipline of economics as a whole. I had closely read much of Rodrik's previously written work, including *Has Globalization Gone Too Far* (Washington: Institute for International Economics), and several of his articles related to institutions, particularly to the primacy of institutions over other factors such as geography or trade in growth. Most of Rodrik's work has indeed been about economic growth. So what could he now say that would be different?

One Economics turns out to be highly significant not because the area it covers is new but due to the keen analysis it provides of previously published works. Indeed, the text draws mostly on the type of published work for which Rodrik and his associates have been most widely recognized for well over a decade. The importance of this particular text derives from the fact that the author has achieved a remarkable synthesis of his own high quality, policy-relevant writings published between the early 1990s and 2005.

One Economics contains nine chapters and a brief introduction. Rodrik believes firmly in the core of neoclassical economics but, to understand growth experiences, he advocates a much more careful application of neoclassical theories than is typical for most economists. One gets the impression from Rodrik's writing that neoclassical analysis is susceptible to the arguments of those with more heterodox views of development policy. Rodrik warns against equating neoclassical economics to freeing all markets, since most of the stellar growth episodes in the last fifty years have occurred under governments that were seriously involved in the process, and in Rodrik's judgment, judiciously so, for the most part.

Chapter 1, *Fifty years of growth (and lack thereof): an interpretation*, summarizes the recent growth record around the world. The main thrust of the chapter is that large scale changes are not required in order to *start* a growth episode lasting several years. However, sustaining the growth process will demand more profound changes in institutions and policies. To determine what changes may need to be pursued, the author argues against the adoption of any comprehensive package of reforms. An example of one such package was the so-called Washington Consensus ("What Washington Means by Policy Reform" in John Williamson (ed.) *Latin American Adjustment: How Much Has Happened?* Washington: Institute for International Economics, 1990), which emerged in the late 1980s and early 1990s. The originally prescribed rules outlined in the Consensus included elements of fiscal and monetary conservatism, as well as elements of economic liberalization, such as greater privatization and deregulation. Many more rules, including those deemed essential to deal with problems in governance, labor markets, and international financial standards were added later to augment the Consensus. The idea was that without achieving institutional transformation the policy principles behind the Washington Consensus would not work. However, it became impossible to follow all these rules simultaneously, leading to the loss of public ownership of the policies. As such, the Consensus disintegrated. Rodrik makes the strong point that the many Latin American countries that attempted to follow the policy prescriptions in line with the Washington Consensus displayed a poor subsequent growth trajectory. The Latin growth experiences can be contrasted with those of several countries in East Asia, which more pragmatically followed government-guided development strategies and achieved stellar growth.

Chapter 1 sets the stage for Chapter 2 on growth diagnostics, which Rodrik had published earlier with Hausmann and Velasco (Stiglitz and Serra, eds., *The Washington Consensus Reconsidered* in 2005; HRV from here on) and which has emerged as one of the most influential papers among development economists and practitioners. HRV's basic approach is to identify the most binding constraints on growth, prioritize them, and try to overcome them. Three constraints apply to most cases of slow growth or stagnation: (1) low private and social returns to investment, (2) poor appropriability of those returns, and (3) inadequate access to finance. Specific factors such as low investment in human capital, weak enforcement of property rights, and underdeveloped financial market are then shown to belong to one umbrella category or another. This leads the analyst to evaluate which of the constraints is the most binding. In practical terms, arriving at such a judgment may take a lot of effort, but once this exercise is accomplished, policy implications naturally emerge.

The diagnostic approach, however, may not be quite as simple as HRV's framework presumes. One of the difficulties a practitioner can encounter is where in the equation to place, for instance, the labor-capital conflicts. HRV say these conflicts belong to the poor appropriability class of factors (category 2, above). But if such conflicts are more common within a given country, perhaps because of sustained civil strife or highly powerful labor unions, such discords may actually indicate low returns on investment instead (category 1). Sometimes, inputs may well be available to a firm, but if they are not usable for reasons that are beyond its control, the inusability of inputs will impinge as hard on the rate of returns as the lack of critical inputs.

Other difficulties in diagnosing constraints could also be pointed out here. However, these are minor quibbles, as HRV illustrate their diagnostic approach by using numbers from several countries in a very revealing way. For example, they analyze Brazil (pp. 68-70, 77-81), which instituted significant reforms in the 1980s and 1990s. Brazilian investment demand and returns on physical and human capital were always high. The country ran a continued deficit in the current account to finance excess investment and, by 1998, faced as high a spread on external bonds as 12 percentage points, indicating costly access to external finance. Forced to devalue in early 1999, Brazil found its real exchange rate depreciating by 37 percent in that year. After another balance of payments crisis in 2002 and a further real exchange depreciation of 38 percent, the current account finally rose to a surplus in 2003, not the least aided by a home recession. This shows that Brazil's lack of domestic saving had made its economy vulnerable to the swings in its access to external capital. When the latter improved, growth kept up; when it deteriorated, growth suffered.

HRV discard a multitude of other factors that would be identified by the standards of Washington Consensus as being detrimental to Brazil's growth and would thus appear to be the main candidates for reform. High taxes and insecure property rights are examples, as neither is good for growth. Yet, private returns on investment have remained very favorable to entrepreneurs in Brazil, causing real interest rate to stay high as well. Hence, reform efforts should not be focused on factors that would ultimately raise those returns even more. Instead, reform efforts would be better directed at improving national saving, since this was the actual binding constraint on growth. Brazilian efforts to improve national saving through taxation did not lead to net public savings because the government had to finance an unsustainably high level of social security and other transfers leaving little opportunity for saving. An even higher rate of taxation and a lower rate of subsidy to human capital accumulation would be desirable in such a case since a policy of pension reform that would raise savings and increase social welfare was politically infeasible.

The chapter on industrial policy (chapter 4) again illustrates Rodrik's unorthodox approach to development policy. Import-substituting industrialization (ISI) strategy has an appeal to all the poor countries aspiring for growth. Yet, the development literature generally discourages an ISI strategy because it gives rise to wasteful rent-seeking and other distortions. The ISI strategy becomes desirable only in a limited set of cases where external economies of scale remain large. Rodrik emphasizes in Chapter 1 how ISI has contributed to growth in many countries, including Turkey and Brazil (p.50). However, successful growth may have taken place simply because these countries started with a low income base and hence displayed a large potential to catch up, in technology and income, with the developed world (as argued by Gerschenkron in *Economic Backwardness in Historical perspective,* Cambridge, MA: Belknap Press, Harvard University, 1962). Or, these growth episodes could have been due to other specific mechanisms that have not been fully explored by Rodrik.

Export subsidies could be another good way to promote growth, Rodrik points out, because they reward "winners" (p.149). However, it is not apparent whether Rodrik comes to such a conclusion after also taking into consideration the loss in consumer welfare that export subsidies produce. In general, however, his description of industrial policies around the world (Table 2) shows how such policies have benefited the respective countries. Rodrik laments the fact that international agreements made at the WTO or through bilateral deals (Table 4.3) have placed restrictions on the kinds of policy space that developing countries need in order to discover their best growth policies. He uses these exhaustive tables to advance his compelling argument that an active role of the state in designing appropriate industrial policy regime can give a growth boost over a substantial period of time. The role of the state is naturally conditioned, he recognizes, on strong leadership that develops immunity to pressures from vested interests and is dynamic enough to adapt national policy to changing circumstances.

Going back to the challenge of development policy to let an economy graduate from growth ignition into growth sustenance, Rodrik discusses an important paper by Imbs and Wocziarg ("Stages of Diversification," *American Economic Review,* 93.1: 63-86, 2003). This paper explores the relationship between a country's income and its concentration in, or diversification across, production sectors. In their study of a large cross-section of countries, Imbs and Wocziarg find that during a long initial stage countries *diversify* as if to explore the sectors in which they might eventually like to settle for production and employment. This stage is then followed at a relatively high income level by another stage in which countries begin going back to *concentration.* A plot of industry concentration against per capita income thus results in a U-shaped pattern that the authors claim to be fairly robust in data. Rodrik takes this result to imply that specialization according to comparative advantage is a wrong path for economies to pursue. Specialization in a few products would not allow them to move on to the second stage. To reach this stage, he argues, countries should try to attain a well diversified production structure.

On the other hand, if a country were to follow an industrial policy without the ability to achieve a big push of investment that would be needed for diversification, how would one prescribe which set of industries to promote? Redding ("Comparative Advantage and the Welfare Effects of Trade," *Oxford Economic Papers*, 51, 15-39, 1999), among others, pushes the criterion of dynamic comparative advantage based on human capital led productivity growth. Nevertheless, identifying the industries with the highest dynamic advantage remains an extremely difficult task in and of itself. Rodrik advocates a contextual analysis for this purpose, but it is not clear how such analysis might lead to a clear solution when the context itself is shifting both within the country itself and without. The author's ultimate solution is to experiment and adapt, much as the Chinese did with their dual-track approach to agricultural reform or the Mauritians did with regard to industrialization (pp.164-68). But successful adaptation requires participation among all affected parties and is therefore a gradual process. The environment created by significant participation by all stakeholders encourages interaction and coalition building and helps achieve better coordination across sectors and social groups. The resulting growth strategy can only strengthen the roots of democracy, even where the western style democratic superstructure is not a prerequisite for growth.

In short, *One Economics, Many Recipes* is a book like no other. The author convincingly explains to the reader the power of his approach to development. He appeals directly to policymakers to work harder to determine what ails a country in pursuing its growth agenda. He acknowledges that there is no quick fix, no standard "menu" of reform options published by multilateral institutions that can be implemented to achieve sustained growth. To Rodrik, there is no avoiding a detailed and careful analysis to identify the most binding of the constraints facing a given country at a given time, especially when many sectors are operating under severely distorted prices. He also claims that there is no set prescription that will deliver durable growth for all times for any given country. In short, all these warnings make Rodrik's book look fairly depressing to growth planners and policymakers. However, while the book demands due diligence on the part of policy makers in applying basic principles of economics to understand major problems facing a country, the text mostly succeeds in the message that steady long-run growth is indeed achievable. The step by step approach of growth diagnostics the book so well emphasizes becomes a remarkable achievement of the author's efforts. Finally, Rodrik asks economists to practice humility in their role as policy advocates (pp.5-6). Of late, multilateral institutions have had to change their approaches to development in the face of their limited achievements in poor countries through the 1990s. Such adaptation of their role as policy advisors should be strengthened as new experiences are acquired. As Rodrik points out, a greater awareness of their shortcomings can only make economists more useful in tackling unanticipated problems.

What impact will this book have? The evidence in favor of growth diagnostics is strong. The World Bank and Inter-American Development Bank have already sponsored many studies investigating this approach, and policy authorities and NGOs have recognized the importance of the contextual analysis of data. Rodrik's own institution (Center for International Development at Harvard) has trained a multitude of economists who are carrying out diagnostic work in several developing countries. With respect to other aspects of the book, particularly the governance of globalization, I suspect the WTO rules will not come into full force for most of the very poor among developing countries. These countries are still facing difficulties in attaining a self-sustained growth path through greater openness and related changes. *One Economics* can only provide them support (p.149) in going slower with fully opening their economies to trade and investment if such a strategy will help them realize faster growth.

Mukti Upadhyay, Ph.D.
Eastern Illinois University
mpupadhyay@eiu.edu