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Keynote Lecture, EcoSoc Conference, United Nations
New York, October 8, 2007

Perspectives on Economic Development

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0. **The Neoclassical Angle**

In neoclassical economic theory there exists no *underdevelopment* at all.
The only "development" is national wealth accumulation.
In a closed economy is identical with domestic capital accumulation.
In an open economy we would add accumulation of assets abroad.

For domestic capital accumulation and the resulting "economic growth" neoclassical economics sees the need for only/mainly
A legal framework:
--property rights
--company law including corporate governance
The "rule of law"
--impersonal law enforcement
--no overriding by the ruler or the democratic government
In fact, the "magic" of the market is overestimated by conservatives: in real business life there are all sorts of imperfects, both in the information and in the knowledge possessed by various categories of participants.
As a result, participants may make huge mistakes.
Many regulations are required to protect participants.
The regulators may also make enormous mistakes.

In fact, there *is* underdevelopment in the world – and there would be even with rather efficient market institutions – as a result of:
Imperfect knowledge in the form of technological backwardness
Deficiencies of human capital that are hard to make up at all quickly
Obstacles arising from corruption in the private and public sectors
Not all well-function "market systems" (i.e., types of market economy) can function well in all environments. (See below.).
Ill-conceived policies: minimum-wage law, unconditional dole, etc.

1. **Escaping Undevelopment through International 'Catch-up'**

China presents a leading example of the emergence from under-development through *technological catch-up*.

A Model of China's Development
Fiscal policy governs disposable income of households and firms
as means to guide the pace of investment in Western technologies.

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The firms on the whole invest mainly in production facilities where required technical leap is least, working their way up the ladder.

--Gradually the "technological gap" is narrowed

--There is a "Ramsey solution" to the optimum speed of catch-up.

An important element of the Chinese model is that, as in other economies emerging from underdevelopment, the consumer must incur learning costs in evaluating and in using new products coming on the market.

That is why *consumption* fell behind *output* until the gap was so large that consumption could finally grow at the same rate as output.

-- As a result, imports have lagged behind exports.

But *transferring 'know-how' in the sense of Hayek – a huge part of it 'private knowledge' and some of that 'personal knowledge' in the sense of Michael Polanyí – is not straightforward: it's problematic!*

2. ***Innovativeness*** **Needed to Catch Up** ***Fully*** **and** ***Stay Up***

There is the example of continental western European economies, which caught up with the technologies in the U.S., Canada and cutting-edge industries in some other countries – it least in terms of best-practice technologies – by the early 1990s but whose productivity growth rates, generally speaking, *could not keep up* with those in South Korea, Finland, Sweden, Ireland, Iceland, Canada and U.S. during the wave of *innovative commercial applications* of the internet from 1995 to 2005 or so – the ICT revolution.

--Now that productivity growth has slowed to a more normal pace in the latter countries, we can expect another episode of catch-up in continental Europe.

Yet, even when *productivity* caught up on the European continent to the frontrunners in the early/mid 1990s, there remained evidence that *overall* performance on the Continent was below that in Canada, U.S., Ireland. *Job satisfaction* and indications of *employee engagement* tend to be lower in France and Italy than in Canada and the U.S. (among big countries).

The explanation? Mine is that the economic systems on the European continent – their economic institutions and their economic culture – generate less *dynamism* than do those of Canada and U.S. (There is direct evidence of less turnover among the largest firms. Market cap higher too.) This "dynamism" I would define as the *fertility* and *originalty* of the economy's business sector (the entrepreneurs) in coming up with new ideas of commercial promise; the *aptness* or *shrewdness* with which the economy's financial sector (the angel investors, the VCs, and so forth) select the innovation proposals for development and marketing; and the attitude of *curiosity* and *experimentalism* among consumers toward any new products that turn up in the shopping mall.

You can see that the growth rate might rise or fall for reasons even if the dynamism inherent in the economy's institutional structure was not changing at all. Dynamism is not well-measured by "growth."

Thus it should *not be taken for granted* that China will catch up fully with West's most dynamic economies. Full catch up by China would require an extraordinary development of its economic institutions and perhaps culture. But there is no reason to be sure it is impossible.

3. **The Journey as the End**

It has to be said that there is something profoundly wrong with thinking of "development" as reaching some static goal such as high productivity or Ramseyan "bliss" – yet that was the view of Keynes, others..
That would mean that the quest for challenge, for problems to solve might come to an end (absent lively hobbies conducted at home):

Such an impact would fall on employees; on managers in formerly innovation-using firms. It would be the end of jobs for some.

It would also mean the end of creative activity on the part of entrepreneurs and their teams

It would be the end of novelty for consumers, for everyone.

It seems safe to say that much of the world will not opt for such a state. Thus "development" ought to be conceived as a *never-ending* process whose continuation is *essential* for current fulfillment of various human needs: mental stimulation, problem-solving, creativity and novelty.

4. **Does the Global Development Process Have an Unfair Side?**

To exports facing competition from the Chinese and from some other countries running large trade surpluses, such a lag of imports by China may seem unfair. There is well-known pressure on China to appreciate the renminbi in order to stimulate consumption and cut export supply.

But that narrow view overlooks *gain* to the global economy that results from the supply of Chinese and other surpluses arising from learning costs: namely the bidding up of asset prices by China and the other surplus countries, which boosts investment expenditures of all kinds (and consumer expenditure too) *in the rest of the world,* thus accomplishing the counterbalancing trade deficits in the rest of the world.

The trouble is that the gainers (those gaining from the higher prices of business assets and others assets, including a great many workers) cannot easily or efficiently be made to compensate the losers out of their gains.

Many economists firmly believe that, preferably, the gainers would compensate the losers.

But that is at least debatable. To some it would not be an unfair world where workers in export trades could not be made to compensate workers in investment-good trades in periods of high interest rate and workers in investment-goods trades could not be made to compensate export workers in low interest rate periods.

--None other than John Rawls, a great moral philosopher, thought that is was the *ex ante* instances of unfairness that society had to rectify and *not* the *ex post* instances. It is disparities in lifetime prospects from early years up to entry in the labor force that are to be addressed – through subsidies for hiring the low-paid, through public education, and so forth.

Rawls did not imagine that the government would undertake to create guarantees against ups and downs of life.

Another source of unfairness is pollution. In tort law, person A is to indemnify person B for any harm that person A voluntarily and regularly causes person B and that person B cannot avoid except at a cost. That does seem unjust and we would expect to demand that person A pay the compensation (if A would rather pay the compensation than stop the harm he is causing.)

So most observers would expect America to do something about its pollution and likewise expect China to do be asked to indemnify countries to the south of Guandong Peninsula.

But what if China is much poorer than the countries it is polluting as it moves up to higher productivity. In the long run, it will undoubtedly meet the same international standards as other high-productivity countries are or will be meeting. What about the short run, however?

--It seems unjust. But most experts expect to see the higher-income countries share in the cost of reducing Chinese pollution.

5. **Is Capitalism Right for All or Most Nations in the Third World?**
Capitalism requires an intricate network of economic institutions, some of which may not have evolved; or they have evolved but they are not good enough to support a well-functioning capitalism –to make capitalism *perform better* than, say, corporatism or socialism or both. Regulatory agencies to protect investors, consumers, etc. may also be underdeveloped, perhaps vitiated by corrupt practices.

But we must be careful. Market socialism and corporatism also need institutions! The idea that state enterprises are naturally transparent, non-abusive and non-corrupt compared to firms operating under capitalism is quite wrong!

Some countries, I suppose, are relatively well equipped to support corporatism well; others to support capitalism well. Ought corporatism get the green light in the former? One trouble is that some countries may get stuck in corporatism, blocking their way to capitalism. Furthermore, now globalization has injected more competition, in some countries the scale may have tipped toward capitalism.