



C A R N E G I E E N D O W M E N T
f o r I n t e r n a t i o n a l P e a c e

“Why Did The Poorest Countries Fail to Catch Up?”

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The following summary was prepared by Kate Vyborny, Junior Fellow at the Carnegie Endowment for International Peace.

Please visit the Trade, Equity and Development homepage at <http://www.carnegieendowment.org/trade> to read the full text of Milanovic’s Carnegie paper, “Why Did the Poorest Countries Fail to Catch Up?” and to view Milanovic’s Powerpoint presentation from this discussion.

Presenter: Branko Milanovic
Discussant: Sanjay Reddy
Moderator: Sandra Polaski

Branko Milanovic

This paper deals with inequality between countries, or “Concept 1” inequality, as classified by Milanovic’s seminal new book on global inequality, *Worlds Apart*. Economic theory predicts that globalized markets for capital and technology will help poor countries “catch up,” as poor countries take advantage of cheaper access to technologies already developed in rich countries, and capital flows to the developing countries where it is more scarce. But since the late 1970s, per capita incomes have actually diverged between countries, and overall the Least Developed Countries (LDCs) have not grown. Milanovic’s statistical analysis weighed the relationship between a number of variables and the rate of growth of LDCs and other countries at different points in time. Many of the factors that might be expected to have an impact had surprisingly little independent relationship with the rate of growth. For example, although Latin American countries’ performance in economic reform (as measured by the World Bank) improved, and the variation between them decreased (as the global range of economic policies narrowed over time), their economic performance was still mixed. Milanovic calculated a measure of policy appropriateness to “net out” the subjective bonus that his statistical analysis showed was received in the index by countries with a higher income. In any case, the effect of reform on LDC growth was small. The level of democracy in a country, as measured by the Polity IV index, and the level of higher education had little impact on growth; and lending LDCs received from international financial institutions such as the World Bank did not have much impact on LDC growth either. One factor which had a large impact, however, was the presence or absence of war or civil strife. While the available data made it impossible to measure the effect of conflicts of different levels of severity, the effect of a variable which indicated whether the country was “at war” or “at peace” was very significant.

Sanjay Reddy

Sanjay Reddy commented that Milanovic's work in disaggregating countries' growth rates at different points in time and analyzing the factors influencing their growth rate is important and challenging to economists. He brought up a number of key points for discussion. Reddy pointed out that the R-squared statistic is very low in many of the regressions in this study, meaning that the variables under examination only explain a small percentage of the observed variation in economic growth rates, which suggests that there are many unaccounted for factors that are of central importance in the determination of growth rates. He therefore cautioned against an unnuanced view of these variables as "*the* determinants" of growth, and suggested that the research show readers more analysis of the robustness of the results, to help clarify which of the variables examined had a reliably significant effect on the performance of the countries studied. Reddy suggested that the prevalence of AIDS, which has a significant impact on development, be included as a variable; for example, while Uganda might appear to be a "winner" in terms of growth in GDP per capita, this may be partially fueled by the effect of AIDS on the "denominator" of per-capita-income: population itself. He also suggested studying a country's level of dependence on non-oil primary commodity exports, the prices of which have, while fluctuating, tended to stagnate or diminish in real terms in the last twenty five years. The resulting instability and deterioration of export incomes has been devastating for specific countries. Finally, Reddy asserted that the effect of aid should not be dismissed on the basis of recent studies (including that of Milanovic, which showed a lack of impact of World Bank and IMF lending on growth). He discussed a forthcoming paper in which he and Camelia Minoiu study the effects of aid on longer term development. This study separated grants and loans into development aid and geopolitical aid, and determined positive effects from development aid, especially over the long term, in a wide variety of regressions.

Discussion Session

Branko Milanovic agreed that the dependence on primary commodities is an important factor, which should be included in this analysis. He has used this data in previous work, and he plans to include it in developing this work further. Sandra Polaski drew attention to a recent global equilibrium model commissioned by Carnegie's Trade, Equity and Development project to simulate Doha round liberalization shows downward pressure on the prices of low skilled manufactured goods, and upward pressure on agricultural prices due to subsidy cuts; this could impact developing countries' terms of trade; she emphasized that the purchasing power of developing countries should be used as a deflator, to account for the mixed effect of price trends in manufactured and agricultural goods on countries which produce or could potentially produce both.

A representative of the World Bank asked about analysis of data from the last ten years, a period in which he said the LDCs had accepted the problem of declining terms of trade and had started to address it proactively. Milanovic agreed that this was an important next step; he pointed out that the past decade was also a period with lower conflict, so it could also have an impact on the results. He cautioned, though, that there had been periods of improvement for LDCs in the past followed by a fall back. Sanjay Reddy said that his earlier work shows LDCs experiencing periods of stagnation, which were common in the 1960s, 1970s and 1980s but much less so in the 1990s. He speculated that an ease in the debt crisis, combined with more permissive policies by the international financial institutions may have played a part in this, but conceded that the causes are likely complex and are not well understood.

A representative of a South African media organization asked whether the lack of focus on Africa at the World Economic Forum in Davos indicated that Africa was becoming less of a priority for the world community. Sanjay Reddy responded that the World Economic Forum reflects the interests primarily of the private sector, which does not perceive Africa as a commercial interest in the short term; he argued that this does not reflect Africa becoming irrelevant to the world community more generally.

A representative of the US Government Accountability Office noted Sanjay Reddy's background in social anthropology, and asked if he could comment on the situation of the LDCs from that perspective. Reddy noted that Nigerian President Obasanjo had commented recently on the role of a lapse in traditional forms of authority in the conflict in the Niger River Delta; there is little way to regulate the social conduct of the youth challenging the authority of the state, who are less bound by the will of their elders and by customary norms, than had previously been the case. Social transformations of this kind, which are taking place throughout the world, are important for development analysts and policy-makers adequately to understand.

Bert Keidel of the Carnegie China program questioned the use of measures of "policy appropriateness," which he argued have to be adjusted to account for the biggest winners, countries like China, which have succeeded precisely by breaking all the rules. He asserted that this may suggest that the measures themselves, and the policies promoted by these institutions, are probably not appropriate. Milanovic pointed out that all the measures tend to show convergence in policies, while the outcomes have diverged; however, the policy measures are flawed in that even within one measure, data may not be strictly comparable over time – for example, ratings for China were higher in the 1980s, when international institutions were impressed by the contrast of new policies of reform, than in 2002, when the policies were clearly more appropriate by the external standards. Sanjay Reddy reiterated that these measures of "good policy" are usually based on prior judgments, rather than on prejudice-free empirical deductions concerning what policies really work. A student asked about the use of indices of corruption or of the ease of doing business; Milanovic responded that these data not only are not available as far back in time, but also that they are perhaps equally subjective, based on the perceptions of foreign firms rather than international organizations.

A representative of the State Department asked for clarification on the differentiation between geopolitical and development aid in Sanjay Reddy's study. Reddy responded that there is no established bright line to differentiate this, but rather aid was classified depending on a number of factors, such as whether the recipient was a former colony of the donor, had a common voting record with the donor in the UN, and any clear strategic interest the donor had in the recipient country. Milanovic said that while Reddy had examined development aid and geopolitical aid, his study examines only multilateral lending, so their results are not necessarily inconsistent: each of these three categories may have a different effect.

An audience member asked the panel to comment on the recent conflict between Chad and the World Bank, in which the Bank has suspended new payments to Chad and raised the interest rate on its existing concessionary loans because of the country's passage of legislation reducing controls on the use of its oil profits which had been a condition of Bank loans. Sanjay Reddy pointed out the conflict between the short and long term interests of the country, as well as the lack of clarity as to whom the government of Chad represented. Milanovic expanded on the North-South and East-West divisions within the country, and the lack of control of the government over the country. He argued that the

issue of “punishment” for Chad’s actions was problematic, as the risk of Chad descending into civil war was a serious concern.