The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics

by William Easterly

MIT Press • 2002 • 356 pages • $17.95 paperback

Reviewed by John T. Wenders

As this is being written, the television talking heads are imploring us "not to walk away" from Afghanistan and to "invest" billions there instead. Before buying into that idea, everyone should read this book by a former World Bank economist whose forthrightness has evidently cost him his job.

Early on, Easterly makes the following observation about foreign investment in Zambia: "I start with a comparison of what Zambians' actual average income would have been, $2 billion of aid later, if [all aid had gone into investment, and investment had gone into growth] as predicted. Zambia today would be an industrialized country with a per capita income of $20,000, instead of its actual condition as one of the poorest countries of the world with a per capita income of $600 (which is one third lower than at independence)."

No single statement more cogently exemplifies the tragic and ironic history of Western attempts to lift the lesser developed countries from their poverty by top-down, government-directed financial aid. No matter where it has been tried, or what methods have been used, it has been a dismal failure. Easterly's book tells us some of the reasons why.

In the past, attempts to alleviate Third World poverty "ranged from foreign aid to investment in machines, from fostering education to controlling population growth, from giving loans conditional on reforms to giving debt relief conditional on reforms. None of these has delivered as promised." To illustrate, Easterly points to the failure to recognize that incentives are what drives successful economic activity. Throwing capital and machines at an economy failed for a simple reason: the capital did not come as a result of someone's perception of a market for its output. The cart was before a nonexistent horse. Incentives create capital; capital without a market is useless.

When throwing physical capital at lesser-developed countries failed miserably, attention turned to increasing human capital—education—with similar results. From 1960 to 1990 the median rate of secondary-school enrollment more than quadrupled, and the median college-enrollment rate has increased more than seven times. "What has been the response of economic growth to the educational explosion? Alas, little or none."

Easterly's explanation is threefold. In economies with extensive government intervention, those with the most education either go into government or turn to lobbying the government for favors, both largely redistributive rather than productive. Further, much of the increased investment in education came from government-mandated schooling, which was just as useless as throwing capital at an economy. In many instances, mandatory schooling actually took children away from productive work. Finally, much of the investment in education is simply worthless. In Pakistan, for example, teaching positions are often dispensed as patronage, cheating is rampant, and teachers cannot pass the exams they administer.

Next, trying to create better incentives for growth, international institutions began making loans conditional on policy reforms. Instead of aid for investment, it was bribery for reform. The failure of incentive lending is confirmed by the admission that the debts cannot be repaid because the loans were unproductive to begin with. "Debt forgiveness grants aid to those recipients that have best proven their ability to misuse that aid, [and] governments will have too strong an incentive to keep borrowing in the expectation that their debt will be forgiven," Easterly writes.

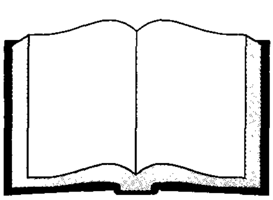
He argues that government might, theoretically, aid the development process. His discussion of the externalities of knowledge and technological change is correct. But it is an unproven stretch to jump from what an all-powerful, well-meaning, benevolent government *could* do to what a real-life government *will* do, especially in light of the government corruption and meddling that Easterly himself describes in detail. He discusses how bureaucracies are corrupt, subvert markets, and create incentives that kill growth, especially in lesser-developed countries where decades of top-down foreign aid have solidified government's hold on the economy. The incentive of many in those governments is to promote policies flatly inconsistent with economic development.

Our author, nevertheless, remains hopeful, even though he often feels "like the clueless advising the helpless." This reviewer is less hopeful. As Mancur Olson has shown, in the absence of revolution, or defeat in war, government sclerosis seldom reforms itself.

Easterly's conclusion that government should stay out of the marketplace is certainly correct. However, many of the problems he cites, like high inflation, black-market premiums, high budget deficits, and negative real interest rates, are merely signs of governments obsessed with redistribution, not production. He naïvely presumes that corruption just happens. The idea that it emanates from unconstrained government power doesn't seem to occur to him.

Like many economists who study economic development, Easterly has been mugged by reality. Now that he has left the World Bank, I hope his next book will go beyond illustrating how aid to foreign governments *has failed* and focus on why it always *will fail.* ☐

John Wenders (jwenders@uidaho.edu) is professor of economics, emeritus, at the University of Idaho.



Dogs and Demons: Tales from the Dark Side of Japan

by Alex Kerr

Hill and Wang • 2001 • 320 pages
$27.00 hardcover; $15.00 paperback

Reviewed by Victor A. Matheson

Dogs and Demons, by expatriate writer Alex Kerr, is another attempt to explain the malaise into which Japan has fallen over the past decade. Japan's real-estate and stock-market bubbles have burst with prices falling to one-quarter their previous highs; the Japanese government's budget deficits dwarf even those run by the United States during the '80s and early '90s; and a banking crisis looms over any possible economic recovery. Why?

Kerr places blame for Japan's troubles on the pervasive and powerful government bureaucracy that creeps into every facet of Japanese life. This unelected administration has had devastating effects on the environment, the culture, and the economy, and threatens to mire the country in a future of unpayable debt.

Japan's oversized construction industry is at the center of the country's problems. The sheer scale of this sector is astounding. As a percentage of the GDP, construction investment constitutes 18.2 percent of the Japanese economy compared to less than half that in the United States. By 2000 Japan was spending 9 percent of its GDP and nearly 40 percent of its government budget on public works, levels roughly ten times that of the United States. It has run out of beneficial projects to undertake and proceeds with projects of questionable value. The public-works sector of the economy has "succeeded" in encasing 55 percent of Japan's coastline in concrete and damming up 97 percent of its rivers. Japan is literally building "the road to nowhere."

Bureaucratic momentum has kept these massive expenditures in place. While nearly all politicians realize the cost these public works place on the nation as a whole, no local official is willing to give up his slice of pork.