I. Prologue: The Quest

- Analogy to the holy grail: we (economists) have tried, but - so far - have been disappointed and have not achieved our goals... There is still hope, though!

II. Why Growth Matters

1. To Help the Poor

- The reality of low GDP per capita: Poverty means oppression, hunger and deaths - often of the most innocent: children
- Infant mortality and GDP per capita
- Health and GDP per capita
- Poorer than poor
- Hunger and GDP per capita
- Oppression of the poor: debt trap
- Growth and poverty are related!!! Growth is better than redistribution

Given this description of the situation: let’s go for the quest!

III. The Panaceas That Failed

Chapters 2-7 deal with six once (and to some extent still) popular theories for explaining why the developing world is not catching up to the first world. In each chapter Easterly reviews some of the relevant literature/theory, then discusses the integration of that theory into World Bank and/or IMF policy, and then the subsequent failure of that policy.
2. Aid for Investment

This section opens by analyzing the efficacy of policies targeted to investment in physical capital. The economic genesis of this approach is the Harrod-Domar model, which essentially posited that investment spending determined growth in gross domestic product. This theory, combined with a famous vision of investment-fueled economic takeoffs proposed by W. W. Rostow in 1960, resulted in the financing-gap approach to development. Under this approach Western donors should fill the financing gap between a country’s own savings rate and the level of investment required for the economy to take off and achieve the desired targeted growth rate.

These programs started shortly after WWII. Since then, looking at episodes of sudden growth, the data suggests that investment is neither necessary nor sufficient.

“Rather than worrying about how much investment is “needed” to sustain a given growth rate, we should concentrate on strengthening incentives to invest in the future and let the various forms of investment play out how they may.”

Missing incentives for investing in the future: crowding out private savings through aid for investment, longevity, political stability,...

3. Solow’s Surprise: Investment Is Not the Key to Growth

Without technological improvements, we converge to a steady state where there is no more growth.

Diminishing returns: eight machines per worker won’t increase productivity of each worker eightfold.

Technological progress: instead give him one better machine... labour-saving technological improvement is needed.

But Solow’s model, while working nicely in explaining within country growth, does not seem to fit cross-country data: rich countries got richer, poor countries stayed poorer—no convergence. Why does (better and better) capital not flow to countries where it is scarce (i.e. returns are high)?

Suggestions:

Human know-how lacking? why not send some skilled and experienced workers over to teach them?

Political instability? High returns on average but very risky???

Lacking demand for these goods? why not export them to places that have a demand? and import other goods?
4. Educated for What?

Machines are not enough—education: one of the principal means to human development?

Education, at least certain basics, may be necessary but definitely not sufficient for sustained growth.

If incentives to invest in the future are lacking, creating skills where there is no technology to use them is not going to foster economic growth.

Lacking incentives:

The most lucrative opportunities for highly skilled people may not lie in activities that increase GDP... lobbying, speculation,... may be more attractive—often because of government regulations spurring those incentives and distracting incentives for growth.

5. Cash for Condoms?

1. Lower population growth ⇒ high economic growth?

2. Development ⇒ low population growth?

2. seems to be more of an empirical regularity. Reason?

Quality versus quantity of children. If rate of return to human capital increases higher than rate of time preference (including mortality effect), this may spark the desire to invest in the future, generate lower population growth and higher GDP growth.

Government actions can reap those benefits, at least partially, by preventing private markets to work properly or by taxing incomes away...

6. The Loans That Were, the Growth That Wasn’t

Given the above failures, the next policy idea Easterly analyzes is one that gives loans conditional on policy reforms.

The problem often was that countries would get loans until they started growing and then wouldn’t get any further loans—creating the incentive for governments to slow down growth, reap the loans and pretend against all odds growth did not kick in.

“Aid should be based on past country performance, not promises, giving the country’s government an incentive to pursue growth-creating policies.”
7. Forgive Us Our Debts

In brief: “Any debt forgiveness granted will result in new borrowing by irresponsible governments until they have mortgaged the future to the same degree as before.”

Interim Conclusion

Easterly does not say that investment, technological progress, education and—maybe—population control are not important for growth. He argues that the implementation of the above theories failed because more basic institutions - such as truly democratic and benevolent governments, judiciary systems that punish corruption and abuse,... - are missing. It is important, he argues to remember basic economic principles: people respond to incentives.

IV. People Respond to Incentives

In the second section Easterly deals with a number of problems with promoting growth in the developing world and proposes possible solutions to these problems, or at least points us in a more productive direction. The most predominant topic in this portion of the book is the role of governments and the people in government in promoting growth. Easterly points out that the incentives faced by governments and their workers in developing countries which receive aid are, for the most part, not conducive to actual reforms which might promote growth. Instead the incentives are for corruption, stalling, appropriation, and deception.

8. Tales of Increasing Returns: Leaks, Matches, and Traps

The presents of increasing—as opposed to diminishing—returns may lead physical and human capital to flow to rich countries, leaving the poor trapped in their poverty. These increasing returns may also be viewed as \textit{complementarity} between old and new technologies which, once an economy falls behind, it will be very hard to catch up since this needs to be done step by step.

To get out of traps, usually, theory says government policy is needed—at least initially. It is dangerous however, since government policy may distort various incentives for growth.

9. Creative Destruction: The Power of Technology

If new technologies \textit{substitute} for old ones, there is a sense in which backward economies have a chance to catch up quickly—by adopting the latest technology.
However, in this creative destruction environment, vested interests tend to be very important and any involvement of governments in these vested interests easily leads to incentives against growth!

10. **Under an Evil Star**

Luck is always a factor of fluctuations around trends. For the poor, these fluctuations can be tragic because they have little to fall back on. Bad luck can kill growth for a while—Governments as in the next section can kill growth altogether.

11. **Governments Can Kill Growth**

“Governments can avoid killing growth by avoiding

1. high inflation,
2. high black market premiums,
3. high budget deficits,
4. strongly negative real interest rates,
5. restrictions on free trade

Recall poverty traps, though...”

12. **Corruption and Growth**

Probably the worst and hardest to combat institutional failure for growth: corruption.

13. **Polarized Peoples**

Too much inequality—to the extreme of completely polarized populations—is usually detrimental for growth.

14. **Conclusion: The View from Lahore**

1. “Private firms and families did not invest in the future because government policies [...] penalized such investments. The poor within each society did not invest in the future because they were matched with other low-productivity people; they require subsidies to their income in order to grow.
2. Governments failed to provide subsidies to the poor and chose policies that penalized growth because polarized factions fought over redistribution of existing income rather than investing in the future.

3. Donors weakened government incentives to reform by propping up nonreformist governments with politically motivated aid.”

**Overall conclusion: what have we learned?**

Through a multitude of examples, Easterly shows how:

- Some economic theories should be rejected on the basis of available data.
- There is a huge gap between theory and implementation of these theories even if the latter have a lot of merit.
- The main reason for this gap is the lack of attention to private incentives, be it citizens, firm owners, governments or donors.

In his attempt to show us how incentive structures for growth can get messed up, Easterly is less precise on concrete remedies. This is not to say that we—economists—should give up on our quest for growth.
Questions

1. Reading experience
   (a) What is your favorite story in the book? Why?
   (b) If you had to summarize the book in 3 to 5 sentences, what would that be?
   (c) What surprised you the most when reading this book?
   (d) What have you learned over and above the theories reviewed in the lectures?
   (e) On what points do you disagree with Easterly?

2. Easterly’s view
   (a) According to Easterly, why did the Harrod-Domar prescription fail?
   (b) According to Easterly, what is the Solow model successful at? Why is the Solow model not very useful in analyzing cross-country discrepancies in growth profiles?
   (c) According to Easterly, why is education not the answer to all our queries?
   (d) According to Easterly, why is population control not the answer to all our queries?
   (e) According to Easterly, why are loans not the answer to all our queries?
   (f) According to Easterly, why can debt forgiveness lead to bad growth outcomes?
   (g) According to Easterly, where do poverty traps come from? How can they be overcome?
   (h) According to Easterly, how do vested interests hamper growth?
   (i) According to Easterly, what is the role of luck in economists’s quest for growth?
   (j) According to Easterly, how can governments kill growth? How does corruption play into this?
   (k) According to Easterly, why are polarized societies an obstacle to growth?

3. Extension
   (a) What could the role of nongovernmental organizations, such as Oxfam, be as opposed to World bank/IMF policies?