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How Rich Countries Got Rich and Why Poor Countries Stay Poor

Erik S. Reinert, *How Rich Countries Got Rich and Why Poor Countries Stay Poor*, New York: Public Affairs, 2008. pp. xxix + 365. \$17.95.

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The economics of development is an important research area of modern economics, even though it is not seen as one of its most prestigious. The reason for this is that most of the research in that branch of economics is carried out, not in the areas that are deemed to be in need of development, but in the research centres of those countries that are viewed as being developed. It is perhaps for this reason that although large numbers of texts and papers are published yearly on the issue of economic development, such publications have almost no effect on those societies about which the researches were carried out.

It is for this reason that, in recent years, there have been growing criticisms of the standard model of neoclassical development economics. This standard model derives from the basic principles of market economics which states that at equilibrium the output of the various factors of production are valued at the most efficient prices. This standard model though dynamic tends eventually to the static condition of equilibrium. The result of this engineering approach to economics has been to create a set of models that are, for the most part, greatly at odds with the empirical reality. It is for this reason that researchers have been seeking to establish alternative schools of thought.

In the area of neoclassical microeconomics, there is the growing influence of the behavioural school which focuses more on the actual choices of economic agents than on those of an ideally rational economic agent. In the area of macroeconomics there is concern that the rational expectations model or the efficient market hypothesis have been empirically at odds with the actual behaviour of investor decisions.

It is for the above reasons that the name heterodox economics has been assigned to those newer theories that have sought to explain economic phenomena in terms quite distinct from the standard neoclassical model. An example of such an approach is that afforded by Erik Reinert's *How Rich Countries got Rich and How Poor Countries Stay Poor*. Other researchers in the same vein are Ha-Joon Chang, K.S. Jomo, and increasingly the prominent economist, Joseph Stiglitz. His text *Globalisation and its Discontents* (2002) has been well received internationally.

Reinert's key idea is that there is a serious disjunction between the recommendations that are offered to developing nations by development officials from the industrialized world and the policies adopted by such nations when they themselves were on the path towards development. Reinert rejects the mantra-like idea of Ricardian comparative advantage economics according to which economic efficiency requires that nations ought to specialize in the production of those items for which they enjoy a comparative advantage and import those goods and services which they produce less efficiently. If such an international trade theory were adhered to, then the result would be that 'the theory of comparative advantage actually may lock poor countries into a poverty trap, into primitivisation: specialising in being poor' (Reinert 304).

Reinert's answer to the problem of development is that developing countries should just follow the same recipe that the industrialized nations adopted when they chose to develop their economies. The strategy was to protect infant industries until such time that they were able to compete effectively internationally. This approach is obviously at odds with the free market paradigm endorsed by neo-liberal economic theory. According to Reinert, the way forward was founded on the principle of 'emulation' (the title of chapter 5 is: 'Emulation: How Rich Countries Got Rich') whereby industrialising nations sought to attain manufacturing parity with their neighbours with the judicious usage of tariffs and patent protection. Emulation meant the importation of raw materials and the exportation of manufactured goods because that was exactly how the economically dynamic nations performed.

In this connection, Reinert informs us that 'in the early 1700s a rule of the thumb developed for economic policy in bilateral trade, a rule that rapidly spread throughout Europe. When a country exported raw materials and imported industrial goods, this was considered *bad trade*. When the same country imported raw materials and exported industrial goods, this was considered *good trade*' (Reinert 89).

In the area of international economics, the last two decades have witnessed the popularisation of the idea of 'globalisation' which has been promoted by

ideologically committed neo-liberal economists. The concept itself is self-explanatory in that it means the 'very rapid integration of economic integration of rich and poor countries both as regards trade and investments' (Reinert 101). Reinert spends two chapters, 'Globalisation: The Arguments in Favour are also the Arguments Against,' and 'Globalisation and Primitivisation: How the Poor Get even Poorer' on the topic to make the contrarian argument that although there may be benefits to globalisation, *ceteris paribus*, there are also arguments against its implementation. There are the palpable benefits of increasing returns to scale, technological change and innovation, but the problem, according to Reinert, is that the framework of static neoclassical analysis is inadequate to capture the fact that when hugely disparate economies – in terms of technological levels, productivity, etc. – are cast into one economic landscape the results are highly skewed.

In fact, the results are such that the Ricardian trade principle of comparative advantage extracts its opportunity cost benefits to such an extent that the poorer countries end up exporting the little amount of human capital and skilled labour that they produce to the more technologically advanced nations. The reason is that they are cheaper to produce in the poorer countries, thus more easily exportable (Reinert 2007: Chapter 4, 'Globalisation: The Arguments in Favour are also the Arguments Against'). The antidote to this is to effect the protectionist trade principles advocated by German economist Friedrich List (1789-1846) whose theories were used to guide modern Germany from underdevelopment to development before embarking on freer trade.

Reinert's central lesson in all this – as further expounded in the chapter 'Globalisation and Primitivisation: How the Poor Get Even Poorer' – is that globalisation just cannot work in a situation where some nations enjoy huge advantages in terms of their respective productive prowess, as a result of more advanced technologies, more developed layers of human capital, etc.

Thus, there is something problematic about the U.S. sponsored neo-liberal gesture such as the Africa Growth and Opportunity Act (AGOA) as in the case of Africa whereby 'Africans may export the products of their unqualified labour force to the US only if all the inputs are brought in from the USA. The Africans have to compete with the Haitians, be even poorer to attract production. The competitiveness of a country, is according to OECD definition, to raise 'real' wages while still remaining competitive on the world markets. In most of the Third World today, this situation is turned upside down: wages are lowered to be internationally competitive' (Reinert 115).

Thus, when there is failure to develop on the part of the developing nations – for which Africa bears the brunt of the negative aspects of globalisation – the neo-liberal explanation offered under the rubric of the Washington consensus has been that the offending nation just did not get the required set

of structural institutions – property rights, prices, governance, education, institutions, diseases, climate, innovations, entrepreneurship, etc. – right (Reinert 216).

This neo-liberal approach, relying mainly on Ricardo's comparative advantage within the context of globalisation, is responsible for the other paternalistic gestures directed towards Africa as 'in the case of the millenium' Development Goals programme. Problems are not attacked from the inside but from the outside (Reinert 240). Thus, the kind of proactive development driven by the Europeans as their own agents that produced an industrialized Europe is eschewed in favour of development 'programmes' that breed dependency. According to Reinert: 'In the place of this economic development that made Europe rich and malaria-free, Africa gets to keep a colonial economic structure, exporting raw materials with an underdeveloped industrial sector. Instead of development enabling the continent to service debt, Africa gets debt cancellations. Instead of development that eradicates malaria, Africa gets mosquito nets. The structural problems underlying Africa's situation are not addressed, just the symptoms of these problems' (Reinert 236).

In the case of Africa specifically, this brings me to a more practical support of the counter-Ricardian hypothesis of abstract comparative advantage. The truth is that the technological and economic disparities between the individual African countries and their global competitors are just too great for each nation to tackle the situation singly. For globalisation to work in the case of Africa, there is need to change the economic landscape so that the small monoculture countries become integrated parts of larger economic units. This would require the relaxation of trade barriers, less restricted movement of goods and services, and the removal of unnecessary tariffs. Reinert does mention the need for regional integration (281), but it is insufficiently stressed. As he puts it with reference to Africa: 'instead of increasing regional integration, intercontinental trade is prematurely replacing regional trade.... The globalisation orchestrated by the Washington Consensus hit the periphery prematurely and asymmetrically, and is therefore doomed to create a group of nations that specialise in being poor within the world division of labour' (281).

But Reinert's general thesis remains sound: the free market recommendations offered to developing nations in general by neo-liberal economists according to the Ricardian principles of comparative advantage just will not work. The example of Mongolia offered by Reinert supports this claim. According to Reinert, Mongolia was chosen to become 'the World Bank's 'star student' of the former Second World' just after the collapse of the Soviet Union. That nation was supposed to follow the free market prescriptions of the World Bank and the IMF. It was supposed to open up its

economy to globalized trade and to specialise in the production of computer software (Reinert pp. 175-179). The result was that Mongolia's growing industrial sector was destroyed, wages were halved and the project of producing computer software was a failure, given that Mongolia's infrastructure was not adequate for such.

The path to development lies in the technologically less developed nations seeking to emulate the more technologically advanced by nurturing and protecting those fledgling industries and technologies that would eventually hope to compete effectively in an environment of freer markets. This brings me to the contradictory position on the investment in human capital undertaken by a number of developing nations. It is obvious that to move from the position of exporter of raw materials to one of manufacturing and industry requires an adequately trained workforce. But even if a certain percentage of this group seeks to migrate to areas where wages are higher, that should not serve as a prohibition against the vital necessity of developing a well educated populace in the first place. A populace educated along modernist lines is ultimately a comparatively better society in terms of its own political and economic interests. Thus, one must take issue with Reinert's idea that unless there is a simultaneous promise of industrialisation, the decision to invest in human capital could be a foolhardy one. Reinert states that an 'education policy must be matched by an industrial policy that creates demand for the graduates' (Reinert 116). Otherwise such individuals would just flee to areas where their skills are better rewarded financially. But not necessarily, if governments make the right investment decisions in terms of capital investments. Furthermore, if there is human capital flight, in many cases it is not permanent.

In actual practice, it would seem that the process of industrialisation should be undertaken in two steps: first, there should be much investment in human capital at all levels; second, the newly trained personnel would then be in charge of those business sectors that would require the managerial, financial and banking personnel to manage the services and manufacturing sectors of the economy. It is the products of the appropriate education policies that would then generate the appropriate industrial policies.

What is also missing from Reinert's analysis is how nations that are on the path of economic development would gain ready access to developmental capital without the constraints usually imposed by the hegemonic IMF and World Bank? The problem is that the nations that seek to industrialise must necessarily obtain capital from somewhere. In the case of Africa, developmental capital has traditionally been obtained from the IMF, World Bank and other lending institutions that rely heavily on the politically motivated recommendations of these two hegemonic institutions.

The solution is that the developing nations, especially those in Africa, seek to capitalise themselves through institutions such as regional or continental central banks, in much the same way that Western nations created their own capital when necessary. Capital provided by Western banking institutions such as the IMF, the World Bank, etc. are necessarily in dollars and must be paid back with interest as such. Under such constraints, there can never be sufficient savings for capital accumulation to effect the required qualitative change from being raw material exporting to value-adding manufacturing nations.

In sum, Reinert's text is to be recommended to those interested in understanding and seeking solutions for the disparate wealth of nations that now plagues the modern world. The majority analysis offered by standard neoclassical economics as embedded in the Washington Consensus is just not adequate. Reinert's heterodox analysis with its emphatically empirical and historical approach 'offers a much more realistic working framework from which to tackle the serious problem of economic development'.