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Development and Social Goals: Balancing Aid and Development to Prevent 'Welfare Colonialism'

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Abstract

The current development policy focus on poverty reduction is erroneous. Historically, successful development policy—from the late fifteenth century until the beginning of the twenty-first—has achieved structural change away from dependence on raw materials and agriculture, adding specialized manufacturing and services subject to increasing returns with a complex division of labour. In contrast, the Millennium Development Goals are heavily biased in favour of palliative economics: alleviating the symptoms of poverty, rather than attacking its real causes. This creates a system of 'welfare colonialism' increasing the dependence of poor countries, thereby hindering, rather than promoting, long-term structural change.

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Erik S. Reinert

> ***"…just as we may avoid widespread physical desolation by rightly turning a stream near its source, so a timely dialectic in the fundamental ideas of social philosophy may spare us untold social wreckage and suffering."***
>
> *Herbert S. Foxwell, Cambridge economist, 1899*

The Millennium Development Goals (MDGs) are noble goals for a world sorely in need of urgent action to solve pressing social problems. They rest, however, upon completely new principles whose long-term effects are neither well thought through nor well understood. In this paper, I shall attempt to explain why the MDGs do not represent good social policy in the long run.

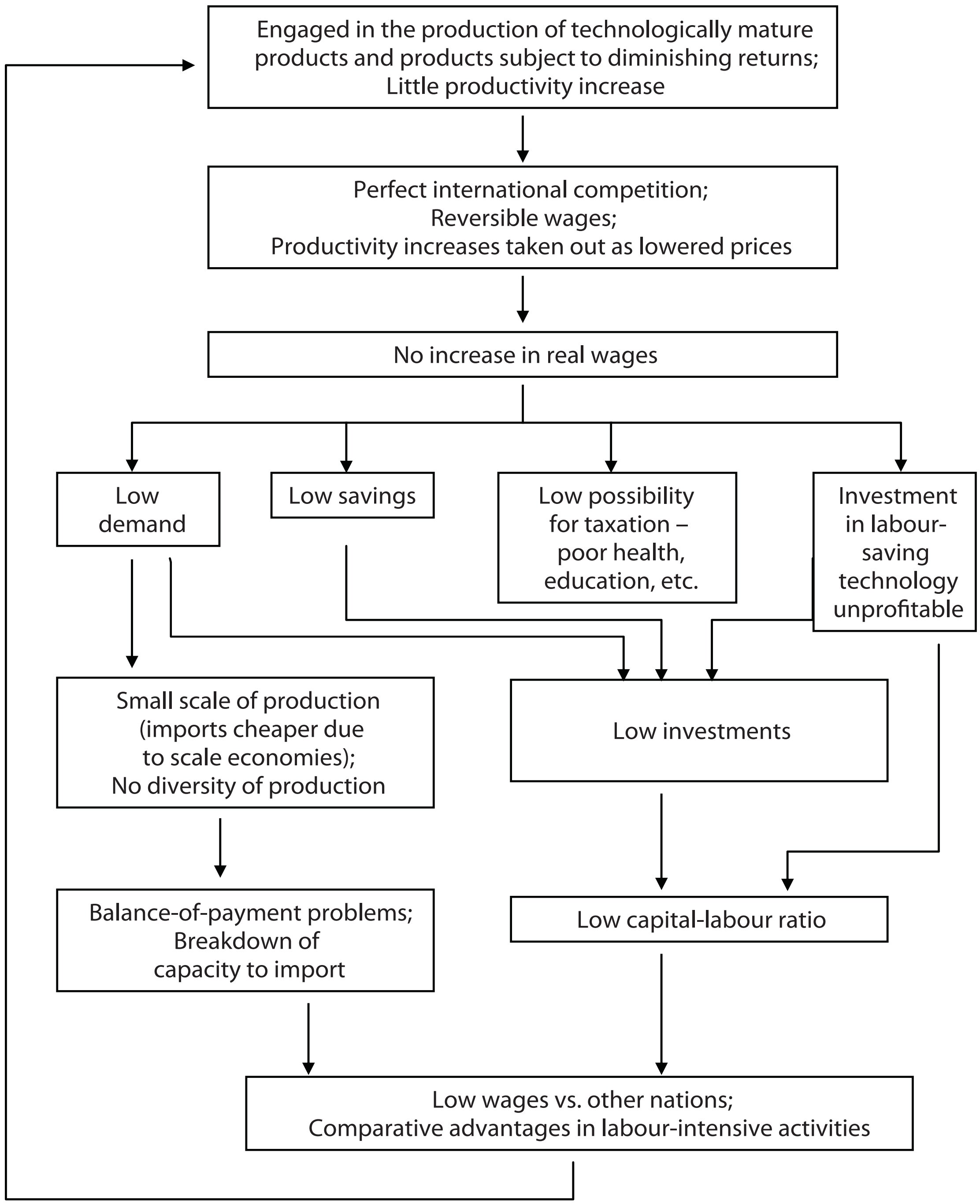
One novelty of the MDG approach lies in the emphasis on foreign financing of domestic social and redistribution policies rather than on domestic financing by the developing countries themselves. Disaster relief, which used to be of a temporary nature, now finds a more permanent form in the MDGs. In countries where more than 50 per cent of the government budget is financed by foreign aid, huge additional resource transfers are being planned. This raises the question of the extent to which this approach will put a large number of nations permanently 'on the dole', a system similar to 'welfare colonialism', which will be discussed at the end of the paper.

The pursuit of the MDGs may appear as if the United Nations institutions have abandoned the effort to treat the causes of poverty and have instead concentrated on attacking its symptoms. In this paper, I shall argue that palliative economics has, to a considerable extent, taken the place of development economics. Indeed, the balance between development economics (radically changing the productive structures of poor countries) and palliative economics (easing the pains of economic misery) is key to avoiding long-term negative effects.

How we used to deal with problems of development

In less than one generation, a stark contrast has emerged between the type of economic understanding underlying the Marshall Plan, on the one hand, and the type of economic theory behind today's multilateral development discourse and the Washington institutions, on the other. The Marshall Plan grew out of recognition of the flaws of its precursor, the Morgenthau Plan. While the goal of the Morgenthau Plan was to deindustrialize Germany, the goal of the Marshall Plan was not only to reindustrialize Germany but also to establish a *cordon sanitaire* of wealthy nations along the borders of the communist bloc in Europe and Asia, from Norway to Japan. The self-enforcing mechanisms that maintain the vicious circles of a Morgenthau Plan are outlined in figure 1 while the virtuous circles of a Marshall Plan are outlined in figure 2.

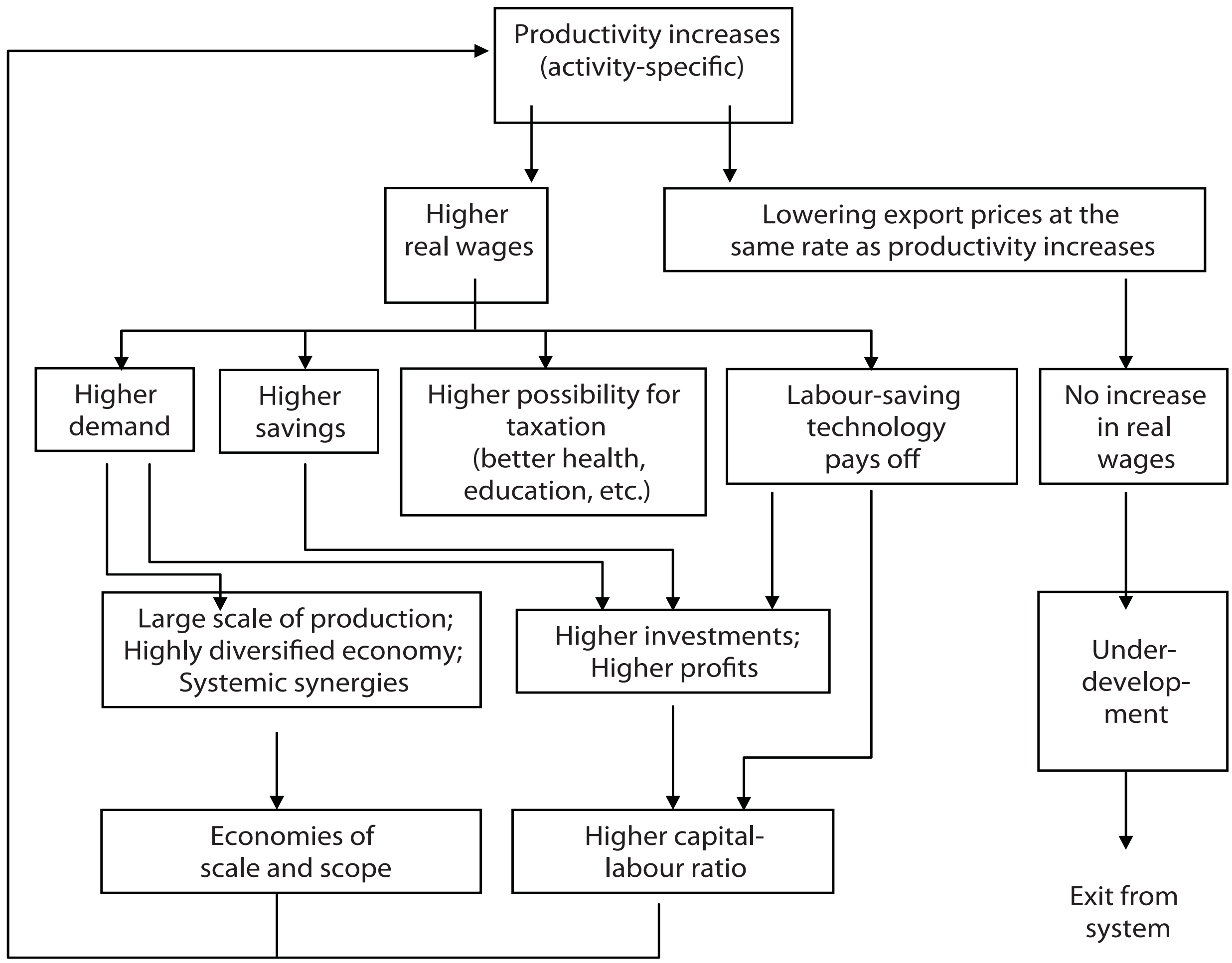
Figure 1. The mechanisms of a Morgenthau Plan: the 'vicious circle' of economic underdevelopment



Source: Reinert (1980:.41).

Note: It is futile to attack the system at any one point, e.g., by increasing investment when wages are still low and demand is absent. An instance of this is poor capital utilization and excess capacity in Latin American least developed countries.

Figure 2. The systemic effects of a Marshall Plan: the 'virtuous circle' of economic development



Source: Reinert (1980: 39).

Note: In a closed system, with a constant employment rate, the only way that GNP per capita can grow is through the "virtuous circle". However, the system can be cut off at any one point, e.g., if higher demand goes to foreign goods alone, the circle will break.

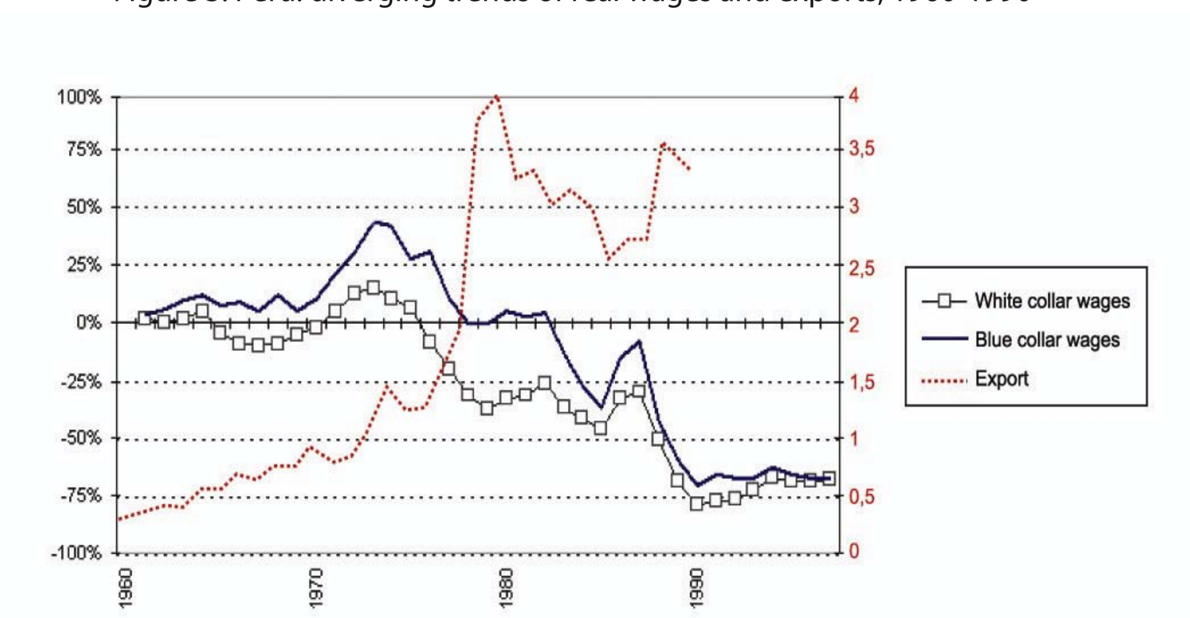
Judging from the number of nations lifted out of poverty, this reindustrialization plan was probably the most successful development project in human history. The fundamental insight behind the Marshall Plan was that the economic activities in the countryside were qualitatively different from those in the cities. In his famous June 1947 speech at Harvard, United States Secretary of State George Marshall (later awarded the Nobel Peace Prize) stressed that "the farmer has always produced the foodstuffs to exchange with the city dweller for the other necessities of life". This division of labour, i.e., between activities with increasing returns in the cities and activities with diminishing returns in the countryside, "is the basis of our modern civilization" said Marshall, adding that at the present time it was threatened with breakdown. In this way, he recognized the relevance of the cameralist and mercantilist economic policies of previous centuries.

Economists and statesmen from Antonio Serra and Alexander Hamilton to Abraham Lincoln and Friedrich List would certainly have agreed that civilization requires activities generating increasing returns. The principles behind the 'toolbox' used by nations going from poverty to wealth, through the creation of 'city activities' (appendix 1), have been surprisingly consistent. Yet, many of today's problems are due to the conditionalities imposed by the Washington institutions that outlaw the use of the policy measures contained in this toolbox.

After World War II, these general principles did not produce the same success in every country. Some of the most successful countries (e.g., the Republic of Korea (South Korea)) temporarily protected new technologies for the world market, while some of the least successful ones permanently protected mature technologies, often for small home markets, by limiting competition (e.g., the small countries of Latin America). Appendix 2 classifies 'good' and 'bad' protectionist practices. In many countries, however, real wages were considerably higher when this inefficient industrial sector was in place than they are today with a much weakened industrial sector (see, for example, figure 3). For centuries it was understood that having an 'inefficient' industrial sector produced higher real wages than having no industrial sector at all, and that this 'inefficient' sector ought to be made more efficient rather than be closed down. Figure 3 suggests that we may have established a world economic order that maximizes international trade rather than international welfare.

In its simplest form, this argument is born out of the role of increasing and diminishing returns in trade theory as the starting points for virtuous and vicious circles of growth or poverty. A praxis ignoring these mechanisms may cause factor price polarization rather than factor price equalization. Serra (1613) first established increasing returns, virtuous circles and large economic diversity as necessary elements for wealth creation. This principle was used almost continuously—with brief interruptions—until it was abandoned with the emergence of the 'Washington Consensus'. Since the 1980s, 'structural adjustment'

Figure 3. Peru: diverging trends of real wages and exports, 1960-1990



has deindustrialized many poor peripheral countries and produced falling real wages.[1] Mainstream theory has long claimed that deindustrialization does not matter. On the contrary, according to the first World Trade Organization (WTO) Director-General, Renato Ruggiero, free trade would unleash "the borderless economy's potential to equalize relations between countries and regions".

In the 1930s, maintaining the gold standard and balancing the budget were viewed as economic fundamentals which locked the world into a sub-optimal equilibrium and prevented Keynes' policies from being carried out. Similarly, having free trade as the ideological centrepiece of development policies since the debt crises of the 1980s has locked the less industrialized countries into a suboptimal equilibrium.

Rather than continuing policies based on the most simplistic version of mainstream trade theory, the conflict between free trade and real wages in non-industrialized countries must be considered seriously. Specialization in activities with diminishing returns in the face of increasing population pressures also has serious environmental consequences (Reinert, 1996).

Poverty in many Third World and former Second World countries is not caused by transitory problems but rather by the permanent features of nations that have different economic structures. Historically, few nations had the ambition to compete with the world industrial leaders of the day. But they understood that compared to being a supplier of raw materials, the nation could massively improve its welfare by industrializing, even if the industrial structure created would end up being less efficient than that of the world leader. The logic is like that of an individual who, instead of being London's most efficient shoeshine boy, raises his income by choosing to become a mediocre lawyer.[2] Thus, when United States started industrializing, its leaders merely wanted to create a (less efficient) version of the production structure in England, a process which required tariffs. Successful industrialization under protection, however, carries the seeds of its own destruction. By the 1880s, United States economists—invoking the same arguments based on scale and technology that were used to protect industries in the United States in the 1820s—argued for free trade. The same tariff that created a manufacturing industry for a period of time was now hurting the same industry (Schoenhof, 1883). This is why Friedrich List, a prominent protectionist, was in favour of global free trade only after all countries had achieved their comparative advantage outside the diminishing returns sector (Reinert, 1998). In other words, he disagreed not over the principle of free trade as such, but rather over its timing.

If one reads Adam Smith, an icon of free trade and laissez-faire, on economic development at an early stage, one finds his views are very much in line with those of classical development economists who advocate industrialization. In his earlier work, *The Theory of Moral Sentiments* (Smith, 1759/1812), Smith argued for 'the great system of government', which is helped by adding new manufactures. Interestingly, he argued that new manufactures are not to be promoted to help suppliers or consumers but in order to improve the 'great system of government'.

1 This analysis is complicated by the fact that the incomes of employees and the self-employed as a share of GDP has been falling in most countries, while profits and earnings—particularly of the FIRE sector (finance, insurance, real estate)—have been growing. This wage/self-employed share of GDP has been close to 70 per cent in Norway and around 23 per cent in Peru.

2 The idea that a nation upgrading its skills in the same way a person could do, was part of the US industrialization strategy from the 1820s (Raymond 1820).

It is also possible to argue that Adam Smith was a misunderstood mercantilist, who strongly supported the mercantilist policies of the past, but argued that they were no longer necessary for England. He praised the Navigation Acts protecting English manufacturing and shipping against Holland, arguing "they are as wise…as if they had all been dictated by the most deliberate wisdom" and holding them to be "perhaps, the wisest of all the commercial regulations of England" (Smith, 1776/1976: I, 486-487). All in all, Smith described a development that had become self-sustaining—a kind of snowball effect—originating in the protectionist measures of the past. Only once did Smith use the term 'invisible hand' in *The Wealth of Nations*—when it sustained the key import substitution goal of mercantilist policies, and the consumer preferred domestic to foreign industry (Smith, 1776/1976: 477). This was only possible when 'the market' took over the role previously played by protective measures, and national manufacturing no longer needed such protection.

The praxis of economic development has been to assimilate and produce less efficient 'copies' of the economic structure of wealthy nations. The key features of the economic structure of wealthy nations—a large division of labour (with a large number of different industries and professions) and a sector with increasing returns (industry and knowledge-intensive services)—were codified by economists such as Antonio Serra (1613), James Steuart (1767), Alexander Hamilton (1791) and Friedrich List (1841/1909). These principles are, at times, unlearned—as in France in the 1760s, Europe in the 1840s and the world in the 1990s.

These periods ultimately came to an end because of their great social costs, however. Physiocracy in France created shortages and scarcity of bread, contributing to the onset of the French revolution (see, for example, Kaplan, 1976). The free trade euphoria of the 1840s met its backlash in 1848, with revolutions in all large European countries except England and Russia. David Ricardo's trade theory has been proven wrong every time it is applied asymmetrically to increasing and diminishing return industries.[3] He is right, however, in saying that the 'natural' wage level is subsistence. The trade liberalization euphoria of the 1990s has increased poverty in several peripheral countries, but our response to this has also been wrong. We have been focusing too much on the symptoms—rather than the causes—of the problem.

The present situation

Standard economics tends to see development as a process largely driven by *accumulation* of investments in physical and human capital. (Nelson 2006). Standard economic theory underlying today's development policies is generally unable to recognize qualitative differences between economic activities. Almost none of today's failed or failing states could pass George Marshall's test for what brings about modern civilization, as they have very weak manufacturing sectors and are unable to generate the virtuous exchange between city and rural activities. They also have very little diversity in their economic base, a limited division of labour and specialize in activities subject to diminishing returns.

Historically, modern democracy began in nations where this civilizing trade between urban and rural areas had already been established, e.g., in the Italian city states. In the most successful city states—including states with a scarcity of arable land, such as Venice and the Dutch Republic—power did not lie with the landowning class. In Florence, 40 or so landowning families were banned from political life in

3 This asymmetry is the core of the argument in Frank Graham's 1923 article, a basis for Krugman's New Trade Theory.

the thirteenth century, thus enabling Schumpeterian 'cronyism' where political and economic interests 'colluded' in ways that created widespread wealth. Dependency on raw materials encouraged feudalism and colonialism, neither of which leads to political freedom. Similarly, the United States Civil War was essentially between the South, where landowners had vested interests in agriculture and cheap labour, and the North, which had vested interests in industrialization. The history of Latin America has been, in many ways, similar to the history of the United States, except that the outcome was analogous to the South's winning the Civil War.

In the alternative economic paradigm—which could broadly be called evolutionary and historical—the process of development is driven by *assimilation*: learning from more advanced countries by 'copying' both their economic structure and their institutions.[4] Key elements in this assimilation strategy are institutions such as patent protection, scientific academies and universities. In this model, economic growth tends to be activity-specific, tied to 'clusters' of economic activities characterized by increasing returns, dynamic imperfect competition and rapid technological progress. In addition to capital, the process requires transferring and mastering skills and, above all, creating a viable market for activities with increasing returns where the absence of purchasing power and massive unemployment tend to go hand in hand. By generally using models assuming full employment, the Washington institutions avoid a key issue that locks nations in poverty—the lack of formal employment. Since sixteenth-century Holland and Venice, only nations with healthy manufacturing sectors have achieved anything close to full employment without massive rural underemployment.

The dominant economic theory today represents what Schumpeter called "the pedestrian view that it is capital *per se* that propels the capitalist engine": development is seen as largely driven by the accumulation of capital, physical or human. According to Richard Nelson, "The premise of neoclassical theory is that, if the investments are made, the acquisition and mastery of new ways of doing things are relatively easy, even automatic" (Nelson 2006). More importantly, a core assumption of standard economics that is seldom acknowledged is that economic structure is irrelevant, as capital *per se* will lead to economic development, regardless of the economic structure within which investment is made. The alternative theory suggests that economic activities have very different windows of opportunity as carriers of economic growth. In other words, we have to rid ourselves of what James Buchanan calls 'the equality assumption' in economic theory, which is probably its most important, but least discussed assumption.[5] The ability, at any time, to absorb innovation and knowledge—and consequently to attract investments—varies enormously from one economic activity to another.

The Problem

Viewing capital *per se* as the key to growth, loans are given to poor nations with productive/industrial structures that are unable to absorb such capital profitably. Interest payments often exceed the rate of return on investments made. 'Financing for development' may therefore take on the characteristics of a pyramid scheme, the only ones to gain being those who started the scheme and who are close to the door (see Kregel, 2004). Similarly, investments in human capital, made without corresponding changes in the productive structure to create demand for the skills acquired, will tend to promote emigration. In both

4 Historical evidence of this practice in Europe can be found in Reinert (2004a).

5 At core, the Enlightenment project was one of ordering the world by creating taxonomies or classification systems, of which Linnaeus's is the best known. Neoclassical economics achieves analytical precision precisely by lacking any taxonomy: everything is qualitatively alike. Therefore its conclusions, like factor price equalization, are essentially already built into its assumptions.

cases, Gunnar Myrdal's 'perverse backwashes' of economic development will be the result: more capital—both monetary and human—will flow from the poor to the rich countries. One explanation for this lies in the type of economic structure—locked into a vicious circle with a lack of supply and demand and an absence of increasing returns—that characterizes poor nations. United States industrial policy from 1820 to 1900 is probably the best example for Third World countries to follow today until these nations are ready to benefit from international trade.

Recommendation

As with the Marshall Plan, funds must be matched by the establishment of industrial and service sectors that can absorb the physical and human investments. Diversification from raw material production is necessary to create a basis for democratic stability and increased welfare, even if the new sectors are initially unable to survive world market competition. This incipient industrialization will need special treatment of the kind afforded by the Marshall Plan and will require interpreting the Bretton Woods agreement in the same manner as in the immediate post-World War II era.

The neoclassical economists' poor understanding of how businesses operate also contributes to the problem. At the core of their economic theory of capitalism is perfect competition and equilibrium, a state which produces very little profit. Any successful and profitable business enterprise rests, almost by definition, on some kind of rent-seeking. The poverty-stricken Third World probably most closely corresponds to conditions of diminishing returns and perfect competition, while the rich countries, whose exports are produced under conditions of Schumpeterian-dynamic imperfect competition, are 'rent seekers', whose rents lead to higher wages and a higher tax base. This failure to understand development as Schumpeterian imperfect competition is at the heart of the arguments against industrial policy. Anything that causes imperfect competition tends to be seen as contributing to corruption and 'cronyism'.

Keynes saw investments as resulting from what he called 'animal spirits'. Without 'animal spirits'—the will to invest in uncertain conditions—capital is sterile, in the worlds of both Joseph Schumpeter and Karl Marx. The motivating force behind 'animal spirits' is the desire to maximize profits, thus upsetting the equilibrium of perfect competition. From a businessman's point of view, poor countries often suffer from low investments because of a lack of profitable investment opportunities, largely due to low purchasing power and high unemployment. Subsistence farmers are not profitable customers for most producers of goods and services. Tariffs can create incentives to move production to the labour markets of the poor. Historically, this has been seen as a conscious trade-off between the interests of 'man-as-a-wage-earner' and 'man-as-a-producer'. The idea that industrialization would rapidly increase employment and wages—which would more than offset the temporarily higher cost of manufactured goods—was at the core of Prebisch's import-substitution industrialization, as well as of United States economic theory around 1820 (see, for example, Raymond, 1820).

The idea that greater 'openness' would improve the lot of the poor countries is both counter-intuitive and contrary to historical experience. In many cases, the sudden 'opening' of a backward economy killed off the little manufacturing activity that existed, thus exacerbating the situation (see Reinert, 2004b; 2003). From the unification of Italy in the nineteenth century to the integration of Mongolia and Peru (see Roca and Simabuco 2004) in the 1990s, historical experience shows that free trade between nations of very different levels of development tends to destroy the most efficient industries in the least efficient countries (the Vanek-Reinert effect). Figure 3 shows how the export increases that followed the opening up of the Peruvian economy were accompanied by falling real wages. In Peru, as in many other Latin American countries, real wages peaked during the period of 'inefficient' import substitution. The ports, airports, roads, power stations, schools, hospitals and service industries created by this inefficient industrial sector led by rent-seekers were *real* and could not have been created without the demand for labour and infrastructure that this sector generated.[6]

The timing of opening an economy is also crucial. Opening up an economy too late can seriously hamper growth, while opening up an economy too early will result in deindustrialization, falling wages[7] and increasing social problems. An anonymous traveller, who observed the effects of economic policy in different European countries in 1786, reached this conclusion: "Tariffs are as harmful to a country after the arts [manufacturing industry] have been established there, as they are useful to it in order to introduce them" (Anonymous, 1786: 31).

Southern Mexico experienced this destructive sequence of deindustrialization, de-agriculturalization[8] and depopulation. That large numbers of subsistence farmers should be made 'uncompetitive' by subsidized First World agriculture is a relatively new, but alarming, trend that may persist even after the subsidies are removed. In India, there are around 650 million farmers, a large proportion of whom will be as 'uncompetitive' as their Mexican colleagues if and when free trade opens up. In the poorest countries today, a trade-off exists between maximizing international trade—which is what present policies achieve—and maximizing human welfare (see figure 3). This trade-off needs to be addressed in a manner different than that of merely compensating the losses of the poor countries through increased aid.

History has shown that the vicious circles of poverty and underdevelopment can be effectively attacked by changing the productive structure of poor and failing states. This entails increasing diversification away from sectors with diminishing returns (traditional raw materials and agriculture) to sectors with increasing returns (technology intensive manufacturing and services), in the process creating a complex division of labour and new social structures. In addition to breaking away from subsistence agriculture, this will create an urban market for goods, which will induce specialization and innovation, bring in new technologies and create alternative employment as well as the economic synergies that unite a nation-state. The key to coherent development is an interplay between sectors with increasing and diminishing returns in the same labour market.

Arguments against industrial policy

Malthusian vs. Schumpeterian cronyism

2005: A Filipino sugar producer uses his political influence to get import protection for his products.

2000: Mayor Daley of Chicago (ignoring the advice of University of Chicago economists) provides subsidies to already wealthy high-tech investors through an incubator programme.

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6 I am grateful to Carlota Perez for having formulated this insight.

7 Though not necessarily falling GDP per capita (see footnote 1).

8 As imported and subsidized United States food takes over from local maize and wheat production.

1950s and 1960s:

Swedish industrialist Marcus Wallenberg uses his close contacts with Labour Party Minister of Finance, Gunnar Sträng, to win political support to carry out his plans for the Swedish companies Volvo and Electrolux.

1877: Steel producers in the United States use their political clout to impose 100 per cent duty on steel rails (Taussig, 1897: 222).

1485: Woolworkers use their connections to King Henry VII to influence the state to give them subsidies and to impose an export duty on raw wool so as to increase raw material prices for their competitors on the Continent, thus slowly killing the wool industry elsewhere, e.g., in Florence.

The above examples all involve crony capitalism and rent-seeking behaviour that mainstream economic theory tends to abhor. A crucial difference separates the first example from the rest, however. The Filipino crony differs from the other cronies in that he gets subsidies for a raw material with diminishing returns that competes in a world market facing perfect competition. In other words, he is a Malthusian crony, leading his country down the path of diminishing returns (in spite of technological change which counteracts this). The others are Schumpeterian cronies, producing under what Schumpeter called historical increasing returns (a combination of both increasing returns and fast technological change). If we couple this with trade theory, we see that the tilted playing fields of Schumpeterian cronyism produce vastly different results than those of the Malthusian crony.

Keynes once said, "the worse the situation, the less laissez-faire works". If we insist on abandoning industrial policy because moving away from perfect competition will cause some cronies to get rich, we have totally misunderstood the nature of capitalism. After all, capitalism *is* about getting away from perfect competition.

Economic development is caused by structural changes which break the equilibrium, creating rents. Insisting on the absence of rents is insisting on a steady and stationary state. There is still a need to choose which activities to protect, however, which in turn creates cronies. Abraham Lincoln protected the steel cronies—by paying a little more for steel,[9] the United States created a huge steel industry with many high-paying jobs that also provided a base for government taxation. Economic development is about aligning the public interests of the nation with the private vested interests of the capitalists. The failure of standard economics to understand the dynamics of the business world will lead to a failure to understand the economic essence of colonialism. By preventing colonies from having their own manufacturing industries, economic activities with high growth potential and mechanization remained in the mother country, whereas activities with diminishing returns went to the colonies.

The immense transfers that accompany the MDG process will necessarily also lead to cronyism. Through this initiative, some will get wealthy, since crony-free economics only exists in neoclassical models. By opting for Schumpeterian cronyism, instead of aid-based cronyism, it will be possible for poor countries to extricate themselves from economic dependency.

We seem to have unlearned the logic behind policy tools for economic development. Patents and modern tariffs were created at about the same time, in the late 1400s. These rent-seeking institutions

9 That the steel tariff later got as high as 100 per cent was a result of technological change and rapidly falling prices in a situation where the tariff was not based on value, but weight (dollars per ton).

were created using the very same understanding of the process of economic development in order to protect knowledge (in the case of patents) and to produce in new geographic areas (in the case of tariffs). Both patents and tariffs represent legalized rent-seeking to promote goals not achievable under perfect competition.

Why are the rent-seeking and cronyism arguments not applied to patents, but only used against tariffs and other policy instruments used in poor countries? With some justification, it can be said that the wealthy countries are establishing rules that legalize constructive rent-seeking in their own countries but prohibit similar ones in the poor countries.

The Washington Consensus and sequential single-issue management

Following the fall of the Berlin Wall, variations of neoclassical economics became the only game in town. Neoclassical economics was, however, in Nicholas Kaldor's term, an *untested theory*. Although neoclassical theory had provided an effective ideological shield during the Cold War, no nation had ever been built on this theoretical framework. In its most extreme form, as practiced around 1990, if nations 'got their prices right', economic growth would follow automatically, regardless of economic structures. By 1990, policy recommendations were formulated around Samuelson's 'law' of factor price equalization and neglected other important theoretical contributions, including key insights by the founding father of neoclassical economics, Alfred Marshall. Marshall had not only described taxes on activities with diminishing returns in order to subsidize activities with increasing returns as being good development policy, but he had also emphasized the importance of a nation's producing in sectors where most technical progress was to be found, as well as the role of synergies (industrial districts).

In the 1990s, as the world economy failed to deliver results following trade liberalization, the search began for other explanations based on the premises of neoclassical economics. The search for a factor which would ensure factor price equalization with free trade resulted in various policy fads:

- 'getting prices right';
- 'getting property rights right';
- 'getting institutions right';
- 'getting governance right';
- 'getting competitiveness right';
- 'getting national innovation systems right';
- 'getting entrepreneurship right'.

This vision of 'the borderless economy's potential to equalize relations between countries and regions' was based on erroneous theory, and instead became a nightmare in many poor countries. As economic growth is an uneven process by nature, only wise political intervention can even out factor price polarizations. Attributing poverty to a lack of entrepreneurship comes across as being particularly uninformed. In contrast to most people in wealthy countries who can make a living on their largely routine jobs, the poor of the world have to use their entrepreneurial talents every day in order to secure sustenance.

This sequence of policy fads failed to address several fundamental blind spots in neoclassical economics:

a) Its inability to register qualitative differences, including the different potentials of economic activities as contributors to economic growth;
b) Its inability to acknowledge synergies and linkages;[10] and
c) Its inability to cope with innovations and novelties, and how these are differently distributed among economic activities.

Together, these blind spots of contemporary mainstream economics prevent many poor countries from developing. China and India—probably today's most successful developing countries—have, for decades, followed the recommendations of the Marshall Plan, rather than the Washington Consensus.

While learning is a key element in development, it may also be passed on in the economy simply as falling prices to foreign consumers. The key insight by Schumpeter's student Hans Singer was that learning and technological change in the production of raw materials, particularly in the absence of a manufacturing sector, tend to lower export prices, rather than increase the standard of living in the raw material producing nation (Singer, 1950). Learning tends to create wealth for producers only when they are part of a close network, once called 'industrialism'—a dynamic system of economic activities subject to increasing productivity through technical change and a complex division of labour. The absence of increasing returns, dynamic imperfect competition and synergies in raw material-producing countries are all part of the mechanisms that perpetuate poverty.

Since the 1990s, huge resources have been increasingly employed by well-intentioned governments along the largely sterile 'mainstream' path of inquiry, without exploring alternative theoretical approaches. The best social policy, however, is to create development, but not by the rich creating subsidized reservations where the poor are kept, largely underemployed and 'underproductive'. The Indian reservations in North America are a sad example of policies that subsidize without changing productive structures. Similarly, the MDGs are far too biased towards palliative economics rather than structural change, i.e., towards treating the symptoms of poverty rather than its causes. While such policies may be needed under current critical conditions, they will remain poor social policies in the longer term unless the deeper roots of the problem are confronted.

Although malaria was endemic to Europe for centuries, present not only in the South but also in the Alpine valleys all the way to the Kola peninsula in north-western Russia, Europe rid itself of the disease through industrialization and development. Advanced and intensive agriculture, irrigation systems, huge public health efforts and eradication plans enabled Europe to eradicate malaria. Europe's development over time also enabled European states to honour their debts.

Instead of embarking on a similar economic development model, Africa continues to preserve colonial economic structures, exporting raw materials and maintaining underdeveloped industrial sectors. Debt cancellation and free mosquito nets merely address the symptoms of these problems.

10 The slogan 'get national innovation systems right' proved to be an exception as it refers to a synergistic phenomenon. However, this does not lead very far because of the theory's inability to distinguish between different windows of opportunity, e.g., for innovation in Microsoft, under hugely increasing returns, and in a goat herding firm in Mongolia, under critically diminishing returns. In standard analysis, Schumpeterian economics tends to be added like thin icing on a thoroughly neoclassical cake.

Creating 'welfare colonialism'

Current policies risk inadvertently undermining the development potential of aid with its palliative effects. What we may be creating is a system that could be described as 'welfare colonialism', a term coined to describe the economic integration of the native population in Northern Canada (Paine, 1977). The essential features of welfare colonialism are:

1) A reversal of the colonial drain of the old days, the net flow of funds going to the colony rather than to the mother country;
2) Integration of the native population in ways that radically undermine their previous livelihoods; and
3) The placing of the native population on unemployment benefits.

In Paine's view, welfare colonialism identifies welfare as the vehicle for stable 'governing at a distance' through exercise of a particularly subtle, 'non-demonstrative' and dependency-generating form of neocolonial social control that pre-empts local autonomy through 'well-intentioned' and 'generous', but ultimately 'morally wrong', policies. Welfare colonialism creates paralyzing dependencies on the 'centre' in a peripheral population, a centre exerting control through incentives that create total economic dependency, thereby preventing political mobilization and autonomy. The social conditions in which the native inhabitants of North American reservations find themselves today show us that, in their case, the final effect of massive transfer payments has been to create a dystopia, rather than a utopia.

The recent discussion on whether or not aid to Ethiopia should be cut as a sanction against the Ethiopian government illustrates the kind of dilemmas which will necessarily accompany "welfare colonialism". The rich countries will always be in the position to cut off aid, food and livelihood sources of poor countries if they disapprove of their national policies. As long as 'development aid' remains palliative, rather than developmental, seemingly generous and well-intentioned development aid will inevitably become extremely powerful mechanisms by which rich countries end up controlling poor countries. Rather than promoting global democracy, such policies will lead towards global plutocracy.

We already see aid and other transfers creating passivity and disincentives to work in poor nations. Haitian observers point to family transfer payments from the United States, which create disincentives to work for a going rate of US$0.30 an hour in Haiti. A Brazilian research project on the highly laudable Zero Hunger Project, carried out at different government levels (national, state and local) for various programmes targeted to fight hunger, concludes that these projects are, to a large extent, ineffective since they treat the symptoms of poverty by distributing food or subsidizing food prices rather than by creating situations where the poor can become breadwinners (Lavinas and Garcia, 2004). These are welfare colonialism effects that result from treating the symptoms, rather than addressing the causes of poverty.

The idea of nations producing under increasing returns (industrialized nations) paying annual compensation to nations producing under constant or diminishing returns (raw material producers) is not a new one. It is a logical conclusion of standard trade theory and has been present in United States college textbooks from the 1970s.[11] Until recently, the favoured option was to industrialize the poor countries,

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11 'Thus the country which eventually specializes completely in the production of X (that is, the commodity whose production function is characterized by increasing returns to scale) might agree to make an income transfer (annually) to the other country, which agrees to specialize completely in Y (that is, the commodity whose production function is characterized by constant returns to scale)' (Chacholiades, 1978: 199). See also Reinert (1980).

even if it meant that their industries would not be competitive in the world market for a considerable period of time. Making free trade the linchpin of the world economic system—one to which all other considerations must yield—has made welfare colonialism appear as the only option. The alternative option of developing the poor world is presently absent because many do not wish to abolish free trade as the core of the world economic order. The long-term and cumulative effects of having this group of nations specialize in pre-industrial economic structures will be staggering, however.

In 1947, political pressure due to the spectre of communism resulted in successful development practices. The free traders in Washington had to yield to the political need for protectionist development policies encircling the communist bloc, which led to the astonishing success of the Marshall Plan in Europe and the East Asian miracle. It is perhaps a faint hope that today's terrorist threat will yield a similar situation where free trade is temporarily abandoned in order to promote development as a *political*, rather than a *social*, goal.

During the Enlightenment, civilization and democracy were understood to be products of a specific type of economic structure. The origins of this understanding can be found more than 100 years earlier; according to Francis Bacon (1620), "There is a startling difference between the life of men in the most civilized province of Europe, and in the wildest and most barbarous districts of New India. This difference comes not from the soil, not from climate, not from race, but *from the arts*". When German economist Johan Jacob Meyen stated in 1770, "It is known that a primitive people does not improve their customs and institutions, later to find useful industries, but the other way around", he expressed something which was considered common sense at the time. Nineteenth-century thinkers, from Abraham Lincoln to Karl Marx, shared the idea that civilization is created by industrialization. As Marx put it, "Industrialization "draws all, even the most barbarian, nations into civilization".

We ought to use our understanding of policies that have been successful in the past to solve today's challenges, while remaining firmly grounded in an understanding of the present technological and historical context. The connection between production and civilization must be understood, and the theoretical focus should shift from trade to production. Different technological developments affect different economic activities, creating huge variations in the windows of opportunity to innovate. Hence, core issues—like economies of scale, specialization, lock-in effects, the effects of diminishing returns, the *assimilation of knowledge*, and the economic structures of poor countries—should not be ignored. We should read not only Schumpeter on technical change and 'creative destruction', but also open our eyes and minds to the type of 'destructive destruction' that can be observed in the peripheral countries of the world.

Europe's present problems reflect the problems of globalization

As mentioned earlier, our present failure to understand why so many countries stay poor is intimately tied to a number of blind spots that make it extremely difficult, if not impossible, to create a theory of uneven economic development. As Lionel Robbins warned us more than 50 years ago, the basic features of the neoclassical paradigm produces a *Harmonielehre*, where economic harmony is already built into the assumptions on which the theory rests. Today, this paradigm hinders, rather than helps, our understanding of the reasons behind poverty. As Thomas Kuhn (1962: 37) said, "A paradigm can, for that matter, even insulate the community from those socially important problems that are not reducible to the puzzle form, because they cannot be stated in terms of the conceptual and instrumental tools the paradigm supplies".

Any long-term solution for Africa and other poor regions will have to rest on a theory of uneven development. This theory, which allowed for successful economic policy for 500 years—from Henry VII's England in 1485 to the integration of Spain and Portugal into the European Union (EU) in 1986—is now virtually extinct. Although a complete outline of this theory and its accompanying policy measures lies beyond the scope of this paper, some core elements can be mentioned here.

The present approach towards the poor is very much tilted in favour of *palliative economics* to ease the pains of poverty rather than to permanently eradicate it through economic development. In addition, the current approach makes it possible to continue and even extend (as in the World Trade Organization (WTO) negotiations) present practices without investigating the problems with globalization in the periphery. The same myths—based on ideology rather than experience—and the same policies are still in place. Keeping in power the same people who introduced the neoclassical shock therapy measures responsible for much of the problem has been a mistake. It virtually guarantees that we do not engage in a fundamental discussion of *what went wrong*. Instead, what is needed is a theory that explains why economic development, by its very nature, is such an uneven process. Only then can the appropriate policy measures be put in place.

The problems created by the currently dominant economic theory are not limited to the Third World countries. In the case of the EU, most developed nations have experienced increasing economic inequalities internally. The same problems are thus experienced on three levels—globally, within the EU and within most developed nations. The cause behind these developments is essentially the same: theories that worked for centuries have been abandoned. Tensions within the European Community are the result of the same economic forces that create poverty around the world. Those in the old member states of the EU feel betrayed because their welfare is being eroded, while those in the new member states feel betrayed because their welfare is not improving as fast as expected. Not surprisingly, this unexpected situation has caused many to ask what went wrong.

Although German economist Friedrich List (1789-1846) is hardly mentioned in today's economic textbooks, his economic principles not only industrialized Continental Europe in the nineteenth century, but also facilitated European integration from the early 1950s up to and including the successful integration of Spain and Portugal into the EU in 1986. It was not until the introduction of the Stability and Growth Pact that List's principles were abandoned in favour of the kind of economics that dominates the Washington Consensus. The result has been increasing unemployment and poverty in the old core countries, inflaming the debate that resulted in the rejection of the proposed new European constitution (see Reinert and Kattel, 2004).

Below are three of List's key principles, which contrasted with standard textbook economics. In order to develop Africa and other poor countries, the present neoclassical economic principles must be abandoned in favour of the old Listian principles.

- ***Listian principle*:** A nation first industrializes and is then gradually integrated economically into nations at the same level of development.
  Neoclassical principle: Free trade is the goal *per se*, even before the required stage of industrialization is achieved. The 2004 EU enlargement was directly at variance with Listian principles. First, the former communist countries in Eastern Europe (with the exception of Hungary) suffered dramatic deindustrialization, unemployment and underemployment. These

countries were then abruptly integrated into the EU, creating enormous economic and social tensions. From the point of view of Western Europe, the factor price equalization promised by international trade theory proved to be an equalization *downward*.

- ***Listian principle*****:** The preconditions for wealth, democracy and political freedom are all the same: a diversified manufacturing sector subject to increasing returns[12] (which historically means manufacturing, but also includes knowledge-intensive services). This was the principle promoted by the first United States Secretary of the Treasury, Alexander Hamilton (1791), upon which the United States economy was built. It was rediscovered by George Marshall in 1947, as mentioned above.
  Neoclassical principle: All economic activities are qualitatively alike, so what is produced does not matter. The ideology is based on 'comparative advantage', without recognizing that it is actually possible for a nation to specialize in being poor and ignorant, engage in economic activities that require little knowledge, and operate under perfect competition and diminishing returns and/or bereft of any scale economies and technological change.
- ***Listian principle*****:** Economic welfare is a result of synergy. The thirteenth century Florentine Chancellor, Brunetto Latini (1210-1294), explained the wealth of cities as a *common weal* ('un ben comune'; see Reinert, 1999).
  Neoclassical principle: "There is no such thing as society", Margaret Thatcher (1987).

As Kuhn described above, these Listian principles cannot be captured by the tools of the reigning economic paradigm. Understanding List requires the recognition of qualitative differences between economic activities, diversity, innovations, synergies and historical sequencing of processes—all of which are blind spots in standard economics.

Working with economic tools that prevent them from understanding List's points, today's mainstream economists grope for explanations of continued poverty. They return to factors that have been studied and discarded, like race and climate, and refuse to see how historical experience demonstrates that the economic structure of wealthy countries have certain characteristics that poor nations lack, e.g., increasing returns, innovation, diversity and synergies. The collapse of the first wave of globalization led economists to eugenics and racial hygiene.[13] Africans were not seen as poor because of the colonial economic structures that had been imposed on the continent, but rather because they were black. Today, the ostensibly more politically correct version of this type of theory is that Africa is poor because blacks are corrupt.

Diversity as a precondition for development

Another blind spot of economics is its inability to understand the importance of diversity for economic growth. Diversity is a key factor in development for a variety of reasons. First, a diversity of activities with increasing returns—maximizing the number of professions in an economy—is the basis for the synergy effects called economic development. This was the standard understanding from the 1600s (see Reinert, 2004 a). Second, modern evolutionary economics point to the importance of diversity as a basis for selection between technologies, products and organizational solutions, all of which are key elements

12 The works of Jane Jacobs on the role of the cities arrive at the same conclusion as List, albeit from a different starting point.

13 Irving Fisher was both a leading economist and the leader of the eugenics movement in the United States in this period. For a discussion, see Ross (1998).

in an evolving market economy (see Nelson and Winter, 1982). Third, diversity has been an important explanation for European 'exceptionalism', where a large number of nation-states, in competition with one another, created tolerance and a demand for diversity. A scholar, whose views were not popular with a particular king or ruler, could find employment in a different nation, thus creating a greater diversity of ideas.

Fourth, religious diversity was emphasized by Johann Friedrich von Pfeiffer (1718-1787), one of the most influential German economists of the eighteenth century. While some economists believe that more rapid economic growth is promoted by some religions, rather than others,[14] Richard Tawney (1926), the famous English historian, emphasized the declining importance of religion in propelling capitalism. About 150 years earlier, Pfeiffer argued that when a diversity of 'competing' religions exists within a state, religion, as an institution, will lose much of its power over the inhabitants. The existence of alternatives will remove fear and other factors that contribute to fanaticism, and a new tolerance will open up for a desirable diversity of its population and skills (Pfeiffer, 1778).

We live in an age of great ignorance today, where established qualitative arguments exploring the process of economic development have been abandoned. The importance of diversity is just one of these arguments. The banality of today's explanations about poverty being a result of climate and corruption amply testifies to this ignorance, which is fortified by the absence of historical knowledge and of an interest in proven principles that have brought nation after nation from poverty to wealth over five centuries. As Paul Krugman has pointed out, previous economic insights tend to fade away, only to be rediscovered later. In a situation similar to the one we are in now, an enlightened group of nineteenth-century German economists caught the ear of Chancellor Bismarck and were allowed to design that country's developmental and welfare state. Similarly, just after World War II, the world understood that economic development was the result of synergies and increasing returns. Combined with the political threat of communism, this understanding made it possible to overrule the free trade ideologies in Washington and reindustrialize Europe and industrialize parts of Asia. In order to restart growth, it is necessary to reinvent this type of economic theory.

Policy implications

Aiming for increasing returns, diversity and the common weal

From an economic point of view, the poor populations on the world periphery may be seen either in terms of *consumption* or in terms of *production*. From the consumption point of view, there are two billion people whose extremely low purchasing power causes them to live on the brink of famine and disease. One suggestion would be to give them more purchasing power through aid, and it is this suggestion that has inspired the MDGs and traditional development assistance. Since many of the victims of poverty are farmers, another normal reaction would be to make their farming more efficient.

These policies, however, go squarely against successful development policies of the past. Only the presence of manufacturing industry produces efficient agriculture. As David Hume (1767) said in his *History of England*, "Promoting husbandry...is never more effectually encouraged than by the increase of manufactures". The conscious creation of such synergies and the economic diversity that makes them possible have been mandatory 'passage points' for all nations going from poverty to wealth since the late 1400s (see Reinert and Reinert, 2005).

14 Werner Sombart emphasized the role of Judaism, and Max Weber the role of Protestantism.

From a production point of view, incorporating insights from David Hume to George Marshall, we get a very different picture which shows a world suffering from a huge *underutilization of resources*, with around two billion people who are severely underemployed or unemployed, engaged in economic activities that are far from 'efficient'. This is the logic found in the original Bretton Woods agreement: poor nations are operating very far from their production possibility frontier, many resources being underutilized.

The Marshall Plan was based on the principle of fully utilizing underutilized resources to protect and create industrialization, diversity and activities with increasing returns in all the nations involved. The post-war interpretation of poverty included assigning a social cost to the underutilization of resources, e.g., unemployment that could be measured using shadow prices, and justified temporary protection to achieve both full employment and a diversified industrial structure. Today, the Washington Consensus uses models assuming full employment, assigning no social or other costs to the fact that human resources in Third World countries are hugely underemployed. Viewing *palliative economics* as the only solution is thus a natural consequence of this view.

In an expanding world economy, where many raw materials are rapidly becoming strategic commodities, the poor 'stand in the way' of access to these raw materials, not unlike the native American 'Indians' being a hindrance to the settlers' use of land. For some United States conservatives, placing the poor on 'reservations' is an option to be seriously considered. Only a decade ago, two American authors recommended the establishment of a *custodial state* in a much publicized book: "by custodial state, we have in mind a high-tech and more lavish version of the Indian reservation for some substantial minority of the nation's population, while the rest of America tries to go about its business" (Herrnstein and Murray, 1994: 526). The MDGs are uncomfortably close to combining the consumption-based view of poverty with the idea of establishing reservations where the basic needs of the poor are taken care of while the rest of the world gets along with its business.

In the original Bretton Woods agreement, unemployment and underemployment justified the protection of national economies until full employment was reached. National development plans—e.g., to industrialize a country—were legitimate reasons for tariff protection under the original Bretton Woods agreement. Similarly, today, it is necessary to temporarily let the free trade principle yield to the principles of economic development and structural change. In short, the conditionalities of the Washington institutions must be subordinated to the original Bretton Woods agreement, as interpreted during its first decades.

In order to implement such policies, we must understand that the process of catching up for very poor countries involves a trade-off between the interests of 'man-the-producer' and 'man-the-consumer'. In addition, we need to realize that static absolute efficiency may differ considerably from long-term income-maximizing efficiency. As Paul Samuelson recently said, "You need more temporary protection for the losers. My belief is that every good cause is worth some inefficiency". (*Süddeutsche Zeitung/New York Times*, 2004: 10).

At the time when England was the only nation to have industrialized, any consideration of *static efficiency* meant that no other nation ought to follow its path to industrialization. All of the nations that followed England's path to wealth did so only by sacrificing *static efficiency* in order to achieve a higher long-term *dynamic efficiency*. Industrializing the United States by targeting and protecting certain industries at that time was just as statically inefficient as protecting Africa's industries is today. The very rapid increase in real wages after the boycotts of the United States (during the Napoleonic Wars), and of South Africa and Rhodesia, testifies to the beneficial effects of protectionism, even when imposed from the outside. It is important to keep in mind, however, that—unlike many Latin American countries after World War II—it is essential to combine protection with national or regional competition. Appendix II establishes guidelines for 'good' and 'bad' protection based on historical experience.

In the poorest periphery, targeting economic diversity has to begin with economic activities that already exist. In the original spirit of Bretton Woods or Keynesian doctrine, one starting point for increasing real employment would be to identify the smallest tariffs which would maximize economic results in terms of employment and national value added, while minimizing the profitability of smuggling. For example, many poor countries import large quantities of poultry from developed countries. A small tariff on poultry could easily create much more employment and value added than the cost of the tariff. It should be kept in mind that tariffs have always played the dual role of producing revenues while creating more productive economic structures. In weak states, ports were often the only territories fully under government control, and tariffs was the easiest form of revenue to collect.

Free trade among nations at the same level of development has always been beneficial. Regional integration is, therefore, key to development. The problem, however, is that poor neighbouring countries often have little to sell to each other. In Africa, pressures from the United States and the EU, together with the spaghetti bowl of regional integration schemes (Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC) Southern African Customs Union (SACU), Southern African Development Community (SADC)) and cross-membership of countries in these schemes, present difficulties for development and discourage policies promoting industrialization under local competition. The pressures to export faced by developing countries undermine, rather than advance, the Listian principle of regional integration that must precede any successful globalization. The EU presses for market access for their apples in Egypt, thereby destroying the century-old tradition of Egypt's buying apples from Lebanon. The present carving up of Africa into different economic spheres is exactly the opposite of what Africa needs, which is stronger economic integration within Africa and a certain degree of development before opening up for globalization.

A unifying characteristic of the 50 poorest countries in the world today is an almost total absence of manufacturing industries. The key insight that having an inefficient manufacturing sector produces a higher standard of living than having no manufacturing sector at all, will have to be recognized in order to transform poor into middle-income nations. Only this insight can stop the parallel race to the bottom in terms of democracy and economic welfare. After all, it was common knowledge in the eighteenth century that democracies were products of diversified economic structures, and not the other way around.

During the last two decades, the United Nations Industrial Development Organization (UNIDO) and other United Nations institutions, such as the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Programme (UNDP), the International Labour Organization (ILO), the Economic Commission for Latin American the Caribbean (ECLAC), the United Nations Research Institute for Social Development (UNRISD) and the United Nations Children's Fund (UNICEF), have been overshadowed by the aggressiveness of the Washington institutions. The United Nations institutions have virtually been bullied into silence, and the political turmoil around the 2003 UNDP report *Making Global Trade Work for People* testifies to this censorship. The report—financed by civil society foundations—was almost withdrawn because of political pressure and was only salvaged due to the intervention of these same foundations. It is indeed time for United Nations agencies to start working together in a more coordinated way in order to be heard.

In 1956, Nobel Economics Laureate Gunnar Myrdal, advised Third World leaders on the subject of economic theory (Myrdal, 1956: 77). He stated that:

> "They should be aware of the fact that very much of these theories are partly rationalizations of the dominant interest in the advanced and rapidly progressing industrial countries…it…would be pathetic if the young social scientists of the under-developed countries got caught in the predilections of the thinking in the advanced countries, which are hampering the scholars there in their efforts to be rational but would be almost deadening to the intellectual strivings of those in the under-developed countries. I would instead wish them to have the courage to throw away large structures of meaningless, irrelevant and sometimes blatantly inadequate doctrines and theoretical approaches and to start out from fresh thinking right from their needs and their problems. This would then take them far beyond the realm of both out-moded Western liberal economics and Marxism."

Appendix 1

'Mercantilist' economic policies of the generic developmental state

Continuity of policy measures and toolkit, from England in 1485 (under Henry VII) to South Korea in the 1960s: a mandatory passage point for economic development.

…the fundamental things apply, as time goes by.

Sam, the pianist, in 'Casablanca'.

1. Recognition of wealth-creating synergies clustered around activities with increasing returns and continuous mechanization. Recognition that 'we are in the wrong business'. Conscious *targeting, support and protection* of activities generating increasing returns.
2. Granting of temporary monopolies/patents/protection to targeted activities in certain geographical areas.
3. Recognition of development as a synergetic phenomenon and, consequently, of the need for a diversified manufacturing sector, 'maximizing the division of labour' (Serra, 1613)—drawing on observations of the Dutch Republic and Venice.
4. Accumulation of empirical evidence showed that the manufacturing sector solved three policy problems endemic to the Third World: increasing national value added (GDP), increasing employment, and balance-of-payment problems.
5. Attraction of foreigners to work in targeted activities (historically, religious persecution was important).
6. Weakening of landed interests (from England under Henry VII to South Korea). (Physiocracy as a reflection of the landowners' rebellion against this policy.)
7. Tax breaks for targeted activities.
8. Cheap credit for targeted activities.
9. Export subsidies for targeted activities.
10. Strong support for the agricultural sector, in spite of its clearly being seen as incapable of independently bringing the nation out of poverty.
11. Emphasis on learning and education (United Kingdom apprentice system under Elizabeth I).
12. Patent protection for valuable knowledge (Venice from the 1490s).
13. Export taxes/bans on raw materials to make them more expensive for competing nations (starting with Henry VII in late 1400s, whose policy was very effective in severely damaging the wool industry in Medici Florence).

Source: Reinert and Reinert (2005).

Appendix 2

Two ideal types of protectionism compared

East Asian: 'good'	*Latin American: 'bad'*
Temporary protection of new industries/products for the world market.	Permanent protection of mature industries/ products for the home market (often very small).
Very steep learning curves compared to the rest of the world.	Learning that lags behind the rest of the world.
Based on a dynamic Schumpeterian view of the world—market-driven 'creative destruction'.	Based on a more static view of the world—planned economy.
Domestic competition maintained.	Little domestic competition.
Core technology locally controlled.	Core technology generally imported from abroad/ assembly of imported parts/'superficial' industrialization.
Massive investment in education/industrial policy created a huge demand for education. Supply of educated people matched demand from industry.	Less emphasis on education/type of industries created did not lead to huge (East Asian) demand for education. Investment in education therefore tends to feed emigration .
Meritocracy—capital, jobs and privileges distributed according to qualifications.	Nepotism in the distribution of capital, jobs and privileges.
Equality of land distribution (South Korea).	Mixed record on land distribution.
Even income distribution increased home market for advanced industrial goods.	Uneven income distribution restricted scale of home market and decreased competitiveness of local industry.
Profits created through dynamic 'Schumpeterian' rent-seeking.	Profits created through static rent-seeking.
Intense cooperation between producers and local suppliers.	Confrontation between producers and local suppliers.
Regulation of technology transfer oriented towards maximizing knowledge transferred.	Regulation of technology transfer oriented towards avoiding 'traps'.

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