TRADE LIBERALIZATION AND GROWTH IN DEVELOPING COUNTRIES

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A half century ago, the non-Communist world was regarded as consisting of two blocks: the industrial countries and the "underdeveloped" countries, as they were then called. The economies of the industrial part of the world were growing at an unprecedented pace. In developing countries (as I shall call them), by contrast, growth was generally at lower rates than in the rich countries. In addition, most developing countries were experiencing very high, and often rising, rates of population growth.

Most assessments of the prospects of the developing countries were therefore pessimistic: with rates of growth of per capita income in industrial countries above those of all but the highest-income group of developing countries, it appeared that not only the absolute gap between living standards, but also the relative gap, would continue increasing.[2] There was also great pessimism about the possibility of declining rates of population growth, which seemed to exacerbate the outlook.

This can easily be seen from numbers given in the early 1960s. While there was considerable variation from country to country, only two countries (both in Africa) were estimated to have grown at rates per capita above 6 percent, while only 9 were in the 4-6 percent range. 43 countries had growth rates less than 2 percent, and 26 in the 2-4 per cent range.[3] From 1950 to 1960, low income countries (then defined as having a per capita income of $265 or less) had experienced falling per capita incomes at an average annual rate of l.4 percent, middle-income (per capita incomes $266-520) and upper-middle income (per capita incomes of $521 to 1,075) had grown at an average annual rates of 2.2 and 2.4 per cent respectively, while higher income developing countries had experienced per capita income growth of 3.2 percent annually during the decade. These numbers contrasted with an average annual 3.0 percent among the industrial countries. And the 1960s saw per capita incomes in the industrial countries accelerating their growth to an average annual rate of 4 per cent, while the developing countries did little better, and some groups did worse, than they had in the preceding decade.[4]

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[2] See Morawetz, (1977).

[3] Morawetz, op. cit., Appendix Table 4.

[4] Data are from Morawetz, op. cit., Appendix Tables 1 and 2. Morawetz' estimates for China are much higher than current estimates for the period prior to 1975, so that a modern estimate of growth rates would place developing countries' average growth rates over the period somewhat lower. But his data were the basis for thinking at the time, which led to pessimism about prospects for "catch-up" even with the overestimate for China.

To be sure, there were some signs of progress in important dimensions in many countries. Life expectancies, which had been abysmally low - 32 years in India, for example--had increased significantly. Health and nutrition indicators also suggested at least modest improvement in most countries. And school enrollments, while still low, had risen.

But overall, living standards were unimaginably low by western standards. Infant mortality rates were over 100 per thousand in many developing countries, and over 200 per thousand in some. Malnutrition was pervasive, especially in rural areas, and water-borne and other diseases were prevalent. Safe drinking water was available only in major cities, albeit often erratically, and it was generally unavailable in rural areas and urban slums.

During the quarter century to 1975, there had been a remarkable similarity of policies in the developing countries. Almost all developing countries had large rural populations, and a large fraction – typically 60-70 percent – engaged in agriculture, which usually accounted for half or more of GDP. There was a widespread view, if not total consensus, that developing countries had to develop their industry and would not, at least initially, be able to compete with manufacturing industries in the industrial countries. It was also thought that, without the development of industry, developing countries would remain poor. Industrialization was equated with development and modernization.

It was generally believed that economic development and rising living standards should be a major, if not the primary, objective of government policy. Given the consensus on that and the need for industrialization, policies were adopted to foster the growth of new industrial activities. While the details varied, the overall thrust of policies was similar in all countries: they in effect prohibited the imports of goods that might compete with newly-established industries. Sometimes, prohibitive tariffs were imposed. In other instances, import licensing was required, and licenses were granted only when it was determined that there was no domestic source of supply available. Often, these (very strong) incentives for establishing new industries were supplemented by domestic content requirements (so that a producer, of e.g. automobiles, would be required to obtain a certain percentage of his parts and components from domestic sources), thus requiring the development of suppliers to manufacturing industries.

It should be pointed out that the import-substitution policies were consistent with, and part of, a development strategy that assumed government intervention and either ownership or regulation of most modern economic activities. The foreign trade and exchange controls were a necessary background against which these other interventions could be effective, and contributed to the difficulties that followed. Space limitations prevent elaboration of the myriad regulations and controls that surrounded economic activity in the "formal economy" of most countries. The interested reader can consult the World Bank's "Doing Business", or a similar source, to glean some idea of the extent of these regulations. Smuggling became widespread, and corruption in the issuance of licenses was the rule rather than the exception. Bureaucratic delays of many months

could shut down a factory or factories for want of an import license for a particular spare part or replacement machine. Administrative efforts to thwart these activities often resulted in reduced production, as delays in receiving raw materials and other needed inputs resulted.

The effects of import-substitution regimes did not immediately become evident. But, over time, would-be entrepreneurs knew that their start-ups would be protected, and paid little heed to cost controls. Resources available for investment were channeled into new industries, sometimes in state economic enterprises and sometimes by rationing scarce credit to private sector firms that would develop the desired products. Producers inevitably found new monopoly positions more attractive than expanding capacity in their existing lines of activity. It was also more profitable for an entrant to establish his own monopoly position than to compete with rivals in an already-existing import-substitution industry. The result was that industries were established that sold on the domestic market at prices often far above those of competing imports; meanwhile, the monopoly positions held by producers often meant that quality was poor, and costs were very high.

At first, many of these activities appeared sensible: assembly of radios and bicycles, production of garments and later textiles, footwear, and similar activities. They were intensive in the use of unskilled labor, had relatively large domestic markets at least in the more populous countries, and did not place excessive burdens on scarce engineering and technical skills or on limited capital resources. But, as the drive for "import-substitution" continued, it was generally necessary to move into activities where costs were intrinsically higher relative to those prevailing internationally because of the small size of the domestic market, lack of skilled workers, and other difficulties. The size of the domestic market was small, and there could either be one firm which met market demand but had a monopoly position, or several small firms, each of which was so small that its costs were high on that account alone. New industries were often increasingly capital-intensive, despite the fact that developing countries had very little capital per person relative to the industrial countries. The fact that producers had little incentive to seek productivity improvements compounded the inefficiencies.

All of these factors contributed to very low productivity growth in developing countries; in some countries it was even negative. The artificially cheap capital goods imports (for those fortunate enough to receive import licenses) encouraged the use of capital-intensive means of production. That, in turn, led to very low rates of growth of employment in the very industries in which growth was to be concentrated. Moreover, in most countries "informal sectors" emerged and grew rapidly; these were economic activities that avoided the bureaucratic controls and regulations that governed economic activity in the new import-substitution industries. They were labor-intensive, but generally very low productivity, without access to imported machinery or equipment, and generally of very small scale.

Moreover, export earnings grew at much lower rates than the demand for imports. This was in significant part because incentives were so highly directed toward

producing goods that would compete with imports that few investments were made in exportable production. Even if there were potentially exportable lines of activity, the requirement that producers use domestic inputs (usually of inferior quality and high cost) and the great attractiveness of investing in import-competing sectors generally discouraged export growth.

In consequence, "balance of payments" crises were frequent among the developing countries. Almost all of these countries (just as the industrial countries) adhered to fixed nominal exchange rates and were reluctant to change them, even though inflation rates were generally higher, and often much higher, than in industrial countries. As inflation proceeded, exporting became less and less profitable at constant nominal exchange rates while imports of those permitted items – the machinery, equipment, raw materials, and intermediate goods used in production of import-competing goods – were becoming relatively cheaper. The authorities usually at first resorted to tighter quantitative restrictions upon imports, permitting only those goods deemed "essential" for domestic production, but even with those restrictions, the day came when it was clear that there was no way to finance even essential imports.

As that time approached and imports were increasingly scarce, domestic production – which was by then heavily dependent upon imports for inputs of raw materials and intermediate goods – leveled off and began to fall. With it, of course, the rate of economic growth fell, if real output did not decline absolutely. Investment was greatly reduced, as much machinery and equipment needed for investment could not be produced domestically and the inability to provide foreign exchange precluded importing it.

To alleviate the foreign exchange crisis, the authorities generally had to take a number of measures, tightening domestic monetary and fiscal policy to reduce inflation and domestic aggregate demand, and devaluing the currency in order to curb import demand and to make exporting more attractive. That tightening, of course, resulted in a further slowdown of economic activity in the short run, although often foreign financial support from the International Monetary Fund, the World Bank, and others enabled importing to resume and consequently production to increase relatively rapidly.

At first, policy makers and analysts blamed "foreign exchange crises" for a slowdown in growth. But it came, slowly, to be recognized that the upswing in each successive "stop-go" cycle was generally shorter than the last, and had a lower overall growth rate, while the downturns were longer-lasting and deeper. In consequence, as the numbers provided above indicated, growth rates in developing countries generally tended to slow down, while at the same time, the overall foreign trade and exchange rate regime became more and more restrictive with increasingly adverse effects on economic growth and living standards.

While many economists accepted the "infant industry" argument – the supposed need for an initial period of "protection" for industries while they developed – many questioned the ways in which protection was provided almost indiscriminately across the

board, extended to virtually any who decided to produce import-competing goods, and retained indefinitely. But the appeal, especially to the modernizing elite, of the argument that in order to have rapid growth and achieve high living standards one had to have domestic industrial development through import substitution, was hardly dented in most developing countries.

Economists had long argued that there were enormous advantages to trade, including the ability to use comparative advantage (as, for example, in producing very unskilled labor-intensive products), the removal of domestic monopoly positions and provision pf competition for producers, and learning from activities abroad. But, in most countries and for a considerable period of time, the arguments fell on deaf ears.[5] In large part, this was because decision-makers in developing countries believed that their industries were sufficiently weak that they would not be able at all to compete with competitors in the developed world. A commitment to "import-substitution" was a central tenet of most governments' stated strategies for economic development.

It should also be mentioned that, in each individual country, it was difficult, if not impossible, to determine the extent to which domestic policies, weather vagaries, or external conditions were contributing to poor economic performance. That enabled analysts to believe that the low growth performance in their country was attributable to factors other than the import-substitution strategy itself. Adverse movements in the terms of trade, bureaucratic failures in administering licensing and other regulations, particulars of the import-substitution strategy, inadequacy of infrastructure, corruption and smuggling, and a host of other reasons were given. In most countries, the policy reaction to the perceived deceleration of growth was to impose even further regulations in an attempt to thwart the undesired behavior, to increase spending on infrastructure, or otherwise intensify efforts, leaving the underlying import-substitution strategy unchanged.

By the late l960s, evidence was beginning to accumulate across countries as to the extent of the failure of the strategy. A major research project, involving leading economic development and trade researchers, was mounted through the National Bureau of Economic Research. Each researcher was to investigate the trade restrictions, trade and payments regime, and their effects, in a particular country. Common questions were set to be addressed in each study. The outcome was a series of ten country studies plus two summary volumes. All but one of the country studies was published, and each of the ten delineated the regulations governing trade and its effects on incentives in the country in question.

The researchers quantified the effects of the trade and payments regime: the variability of the real exchange rate, the protection actually accorded to imports, the differentials in incentives for producing exportables and import-competing goods, and so on. They also reported the inefficiencies associated with the import substitution strategies in their individual countries.

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[5] See, for example, Bhagwati and Srinivasan (1975) on India, Hansen (1975) on Egypt and Krueger (1974) on Turkey.

Interestingly, individual researchers' findings were each suggestive, but not conclusive, of the detrimental effects of these import-substitution regimes. But when the results of the individual studies were compared, what was striking was the similarity of the overall effects of these regimes. Infant industries had become "senescent" without any period of adulthood and competitiveness in between. Few, if any, of the encouraged industries had become able to compete on world markets, and protection had seldom been reduced, much less removed; indeed, levels of protection for many new industries had often increased over time.

The economic inefficiencies encouraged by import substitution regimes were glaringly evident. For example, a policy to ration scarce foreign exchange to producers in proportion to their productive capacities had resulted in expansion of each firm in the industry, in an effort to increase share, when there were already insufficient imports to enable existing capacity to be reasonably fully utilized. The same policy also gave each producer a guaranteed share of the market, as the amounts that each could produce was broadly determined by their imports of intermediate goods and raw materials.

These, and related, findings[6] were met initially with considerable skepticism, so entrenched were the beliefs in import substitution. But, during the 1960s, South Korea and Taiwan began to follow an alternative approach, in which they dramatically altered their economic policies. I shall recount the broad outlines of the South Korean story here, partly because it is one of the most dramatic, and partly for lack of space to do more. That story well illustrates the benefits of the alternative strategy and the enormous advances in economic (and political) well-being of the South Korean people that resulted.

As of 1960, South Korea was one of the poorest countries in Asia (which was then still the continent – except Japan – which had the lowest per capita income). Its per capita income is estimated to have been very close to that of India. A Japanese colony until 1946, South Korea had then experienced a bout of hyperinflation, followed by the Korean War from 1950 to l953 during which battles were fought up and down the peninsula with widespread destruction.

During the rest of the 1950s after the end of the war, South Korean economic growth, even during the reconstruction period when it should have been rapid, never exceeded 5 per cent, which meant that per capita income was increasing at less than 2.5 percent annually, after its big drop during the Korean War. And that was despite large foreign aid inflows (averaging close to 10 percent of GDP).

South Korean economic policies were directed toward import-substitution. Exports, of which 88 percent were primary commodities, grew very slowly. The country

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[6] Perhaps the most important earlier research project had been led by Little, Scitovsky and Scott (1970) under the auspices of the OECD. Their findings focused on industrialization, rather than the trade regime itself, and were entirely consistent with the results of the later study. The cumulative impact of these systematic comparisons, along with individual studies of circumstances in particular countries, was highly significant. And it was probably necessary to have a number of studies before those adhering to the import-substitution philosophy and strategy were willing to reconsider. Even with all of the evidence, the authorities in some countries adjusted their policies much more rapidly than those in other countries.

had the then-highest rate of inflation in the world (officially at 25 percent annually, but judged by many observers to be much higher as price controls were in effects), and large government budget deficits. The nominal exchange rate was kept constant for long periods despite the high rate of inflation, with import surcharges often imposed on top of highly restrictive import licensing. Even with the surcharges, import licenses were very valuable commodities, and favoritism and corruption surrounded the administration of the licensing regime.[7]

South Korea seemed economically disadvantaged. It had the highest rate of population density in agriculture in the world, despite a mountainous and inhospitable terrain. There were few natural resources. Population growth was rapid. The domestic savings rate was close to zero, with virtually all investment financed by foreign aid receipts.

Even several years after the Korean War, economic prospects did not seem to have improved significantly. Growth rates were still in the 3-5 percent range, very low given reconstruction, while inflation was high, and prospects for improvement seemed dim. The American Congress, in debating foreign aid in the mid-1950s, concluded that there was little or no hope for sustained growth in South Korea, and that henceforth the volume of aid should start declining, and that aid should be limited to goods for "sustaining" the population, rather than attempting to support more rapid growth.[8]

The prospects of declining aid, and other factors, were quite clearly a shock to the Korean people. Recounting all of the factors that went into policy reform would take us too far afield – books have been written on the subject.[9] But the first step in policy reform was taken shortly thereafter, in 1958. A stabilization program was undertaken, with support of the International Monetary Fund, which removed many of the inefficiencies of the multiple exchange rate regime, led to a reduction in the rate of inflation, and moved to a more realistic exchange rate.

That, however, was only the first step. By 1960, measures were taken so that exporters could obtain needed imports at world prices and do so without the delays that had accompanied import licensing. They were also entitled, and given priority, to allocations of domestic credit (which was still rationed at very low interest rates). The authorities began offsetting the effects of domestic inflation by altering the rate of exchange of foreign exchange earned by exporters for domestic currency. All of these measures were aimed at encouraging exporting activities: it did not matter what was exporter: entitlements to credit, tax provisions, and won receipts for dollars earned were the same for all.

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[7] Growing corruption and generally unsatisfactory economic performance were major factors in bringing about the overthrow of the Rhee regime in 1960. Analysts of the early 1960s suggest that the Park Chung Hee government was generally supported at that time because of the improved economic performance. See Mason et al for a discussion.

[8] In the early 1960s, World Bank analyses of the Korean economy reported that the resource base and other initial conditions were such that industrial growth in Korea was not feasible.

[9] See, for example, Cole and Lyman, 1971 and Mason, Perkins et al (1980).

Except for the provision that exporters could get their needed imports duty-free, little was done initially to dismantle the high rates of protection extended to import-competing producers. But the export incentives, which were available to all exporters, without discrimination as to the nature of the product being sold, were sufficient to offset almost all of the bias that had existed against exporting in the prior trade and payments regime.[10]

By 1963, the authorities began addressing problems of macroeconomic stability, reforming their tax and public expenditure policies so that inflationary pressures were greatly diminished. By the mid l960s, inflation had fallen to single digits and, simultaneously, interest rates were increased so that they were above the rate of inflation. Duties on imports were greatly reduced by the late 1960s (and even further in later years). And, over the next several decades, additional policy reforms were undertaken to support economic growth.

For present purposes, the important points are two: first, the sea-change in economic policy undertaken by the Koreans was largely in line with the economic policies of open trade advocated by economists, and very different from the sorts of policies that were still being pursued in most developing countries; and second, the results were spectacular: peoples' lives were transformed.

It is hard to convey the magnitude and extent of the transformation. In 1960, Korea's per capita income, in 1990 prices, is estimated to have been $1302. By 1970, it had almost doubled, to $2208; by 1990, it was $8977, or almost 7 times the 1960 level. Over the entire period from 1963 to 1995, real national income is estimated to have grown at an average annual rate of 7.89 percent.[11]To put that in comparative perspective, in 1960, Korea's per capita income was about 12 percent of U. S. per capita income, and less than three quarters of that of Ghana. By 1990, Korea's per capita income was over 40 percent that of the U.S. and 9 times that of Ghana.[12] Korea was no longer a developing country: it was a "newly industrialized country", or "emerging market".

During the first decade of Korea's remarkable growth story, export value (in U.S. dollars) grew at the phenomenal and unheard-of average annual rate of 40 percent. In 1985 prices, exports rose from 2.4 per cent of GDP in 1961, to 11.1 per cent of GDP in l970, to 32 percent of GDP by 1980, and 39.0 percent by l992. Of these, 15 percent had been manufactured exports in 1960, 77 percent in 19760, and 93.8 percent by 1990.[13] This, of course, completely undermined the arguments of those who had said that manufacturing industries in developing countries could never be started and become internationally competitive without protection from international competitors.

[10] See the estimates in Frank, Kim and Westphal (1975) and reported in Krueger (1978).
[11] Data are from Kim and Hong (1997).
[12] Estimates for 2006 put Korean per capita income at $23,800, the U.S. at $44,260, and Ghana at $2,640. See World Bank (2008), Appendix Table 1.
[13] Cha, Kim and Perkins, Editors (1997), pp 61-62.

But the improvement in peoples' lives went well beyond improved living standards and a release from poverty. In l964, it is estimated that about 16 percent of the urban labor force was unemployed. That figure fell to about 7 percent by the late l960s, and to less than 3 per cent by 1988. Simultaneously, average real wages in manufacturing grew at a breathtaking rate of 8 percent annually over the subsequent 3 decades, and Korean income distribution remained more equal than that of most developing countries and relatively unchanged until the 1980s.

The rate of population growth decreased sharply: whereas population growth had been 2.4 percent in the 1963-70 period, it fell to 0.5 percent by the first few years of the 21st century. Life expectancies increased dramatically, from 54 and 58 years for men and women respectively in 1960 to 63 and 67 by l970[14] and to 74 and 81 in 2005. The infant mortality rate, which had been 85 per thousand in 1960 had fallen to 21 per thousand by 1991 (data from Mason et al P. 90).

There was also a major shift from rural to urban areas and employment. In 1961, 48.8 percent of GDP had originated in agriculture and mining; by 1993, the figure had fallen to 7.4 percent. (Cha, Kim and Perkins, P. 61), while that of the industrial sector had risen from 12.3 percent to 43 percent. Educational attainments of the population also rose sharply: in 1960, 43 percent of the over age-15 population had had no formal education, and only 10.2 percent had had more than primary school education. By 1995, only 6.5 percent of the over-15 population had no formal education, and 80 percent had more than a primary education.

One could continue: the savings rate rose dramatically, from virtually 0 to over 30 percent; the rate of productivity growth increased remarkably; and so on. Overall, the quality of life for the vast majority of the Korean people was transformed. From an uneducated, rural, poor and short-lived population, the people were much more highly educated, urban, reasonably well off, and with life expectancies matching those in other industrial countries.

Discussion of the Asian crisis, and Korea's crisis of the late l990s, would take us too far afield. Two things should be noted, however. First, even at the depth of the crisis in 1998, Korean per capita incomes were well above those of countries such as India and Ghana; Koreans were still better off than in the l960s by a much wider margin than people in most developing countries. Second, after the onset of the crisis, growth had resumed in less than a year and a half, and Korean economic growth has continued since that time at around 5 percent a year, as the per capita income numbers cited above indicate.

But, the more general point is that, while it took many policy reforms to enable the Korean economy to achieve such a spectacular transformation, trade liberalization was hugely important, and probably a sine qua non, for it to happen. Peoples' lives in

[14] Mason, Kim, Perkins, Kim, and Cole, (1980). Data for l960 and 1970 are from Table 107, p. 398. Data for 2005 are from World Bank (2008).

Korea were transformed, in terms of health and nutrition, education, and all indicators of well being.

After the Korean experience (and that of Taiwan, Hong Kong and Singapore), other countries began altering their economic policies and their trade and payments regime in the late 1970s. In Asia, the next countries to change policies were in Southeast Asia, with China abandoning inner-looking policies in the early 1980s. The rapid rate of growth of the Chinese economy is well known to all; that living standards have risen, and that millions have been lifted out of poverty is a consequence.

Indian economic reforms began a decade later than the Chinese, but in recent years Indian economic growth has accelerated sharply. All estimates of the improvement in living standards suggest great strides forward in what was an extremely poor country; estimates are that the percentage in poverty has fallen dramatically. It was earlier mentioned that Indian average life expectancy in the 1950s was 34 years of age; it is now well above 60.

But there have been substantial reforms and significant improvements in other countries. The Chilean economy was transformed by policy reforms that began in the mid 1970s. Mexico liberalized significantly in the late 1980s and cemented that liberalization by joining NAFTA. Among developing countries as a group, trade barriers have dropped sharply. Even in Africa, which has arguably been the slowest to reform, tariff rates began falling and quantitative restrictions began diminishing in importance by the turn of the century.

Economic growth is generally faster in countries with more open trade regimes.[15] In part, this is because of the gains that accrue through openness itself. But in significant part, openness is a "forcing variable" – that is, there are many counterproductive policies that may tempt policy makers in countries with inner-oriented policies that they either cannot adopt or are quickly led to abandon in countries with outer-oriented trade regimes. An easy illustration is import licensing itself: once an outer-oriented trade strategy is adopted, licensing must quickly be abandoned for exporters. Once that happens, the overall restrictiveness of the regime is greatly diminished. And once exports have begun growing rapidly, further relaxation of the regime, and finally abandonment, follows. But there are other policies that are affected: establishing state owned enterprises, or even prohibiting imports to establish a new industry, is no longer a feasible policy. And government controls over expansion plans and other aspects of firm behavior must be relaxed very rapidly. As exports grow, policy in general becomes more exporter-, and therefore, more market-friendly, and with it policies tend to rely more on incentives and less on direct controls.

Among other policy reforms that have made a difference has been fiscal and monetary policy. In earlier years, most developing countries had double digit, and sometimes triple-digit rates of inflation. One lesson that has been learned from research into expenditure patterns and behavior of different income groups in developing countries

[15] See, for example, Sachs and Warner (1995), and Krueger and Berg (2003) and the references cited there.

is the extent to which the poor are harmed by inflation and to which the rich can protect themselves, and even profit. Today, there are very few countries in the world with double digit inflation, and the average inflation rate in developing countries is in the single digits. From the viewpoint of encouraging better economic performance and more rapid economic growth, changes in inflation rates and fiscal policy have had a very significant and positive impact both in terms of the effects on overall economic growth and in terms of the positive impact on the poor.

As a consequence of trade liberalization and other economic policy reforms, economic growth has accelerated in most of the developing world, with the most rapid growth in the countries whose reforms have gone furthest. The world economy as a whole has experienced very high growth rates over the past five years, and that has certainly enabled developing countries to grow more rapidly. But the most rapid growth has generally been in countries whose reforms have been most pronounced, or which were already outer-oriented. The Chinese experience is certainly the most dramatic example but progress has accelerated in many others.

Even in Sub-Saharan Africa, where the terrible effects of AIDS have been a major drag on growth, and where policy reforms are at an earlier stage, the average rate of economic growth has been above 5 percent for the past three years, contrasted with zero or negative growth of per capita incomes in many of those same countries in the 1980s and 1990s. The rate of population growth is still high, and poverty is still pervasive, but signals are much more hopeful than was earlier the case.

Life expectances in most developing countries are much higher than they were in the early l950s, the exception being those African countries where AIDS has taken a huge toll. . Life expectancy depends to some extent on health care delivery, but also importantly on nutrition and other aspects of living standards and higher per capita incomes. Overall, not only has life expectancy risen to an average of about 64 years from its earlier 40 years, but the gap between the industrial countries' average life expectancy (which was above 60 years in 1950 and is now above 70) is much smaller.

Similarly, literacy rates have increased sharply, as have average levels of educational attainment. While there is considerable variation in the extent of improvement among countries – with some countries reaching almost 100 percent literacy of those 15 and older[16] - the overall achievements represent major progress in most countries.

In a nutshell, whereas in the l960s and l970s there were ample grounds for fearing that the divide between the rich and the poor countries would widen, there is now a basis for expecting that many, if not most, can be lifted out of poverty. Improvements in understanding of economic policies and their impact have played a key role in permitting this change.

[16] See World Bank (2007), Table 1 for recent numbers.

This is not to assert that all is well: there are still more than a billion people living on less than a dollar a day, many of them in Sub Saharan Africa, but also in south Central Asia, and a few other countries.[17] Learning more about ways to address the very severe problems of some of these countries remains challenging, and there is much still to be learned about economic policies and their impact in emerging markets and in industrial countries as well. One of the lessons of the past fifty years is that economic growth and change require policy improvements and reforms if growth is to be sustained: policies that can support an initial acceleration of growth, such as in Korea in the early 1960s, must be further amended if growth is to be sustained.

But the accrued understanding of what is needed of the past half century has enabled a major transformation in the world economy and in many peoples' lives. Even in countries where policies are not yet sufficiently conducive to rapid growth, some of the changes that have been made, such as reduced inflation, mean that when other policies are altered, their positive effects can be larger and more immediately felt. If policies in developed and developing countries alike continue to sustain growth and use the knowledge that has been acquired,[18] there is every reason to believe that further progress can take place, and even accelerate relative to the past.

[17] See Collier (2007) for an account.

[18] One key issue is the future of the international trading system. As this is being written in the fall of 2007, the outcome of the Doha Round of trade negotiations under the WTO is still in doubt. A successful conclusion would augur well for future economic gains; failure would be dangerous for all, but probably most harmful for developing countries.

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