

“What have we learned about development economics?”

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Six Basic Issues

The presentation we just heard was excellent, and focused on a range of macroeconomic issues. I am not going to critique it but to complement it, and mention five areas more microeconomic in their orientation where I feel that we may have learned something about development in the last few decades but which Professor Bannerji did not have time to mention. This list covers deregulation, outsourcing, microfinance, environment and technology. Interestingly, one of the themes of much of Professor Bannerji’s own research is the importance of the micro dimensions of economic development, so my comments are very much in the intellectual tradition he has helped to establish.

Deregulation

Top of the list is deregulation. This appears to have been instrumental in generating higher growth rates in China and India, and perhaps other countries as well. Deregulation certainly released entrepreneurship and generated investment in China, and contributed to the ending of the “Hindu growth rate” in India. But it is clear that deregulation can also produce growing inequality, something dramatically visible in China. Of course neither China nor India is fully deregulated: in fact both are heavily regulated by western standards – but the point is that they are less regulated than they were a couple of decades ago. A move from heavy regulation to a more market-oriented system can release pent-up energies and talents and provide a dramatic boost to the economy. There are still many countries that are on the regulated side of the divide between too much and too little regulation, though the recent financial crisis may have reduced the West’s authority when it comes to preaching deregulation.

Outsourcing

Outsourcing is controversial and indeed generally viewed negatively by

the press and the political classes in western countries. However it was central in generating foreign direct investment in China, India and many other Asian countries [Heal 2008]. In general outsourcing has occurred in labor-intensive manufacturing in China, in business process outsourcing and software in India, and in labor-intensive manufacturing in other developing countries. It has generated employment, raised wages, and helps the process of technology transfer [Harrison and Scorse 2007].

Microfinance

Microfinance is another theme that has recurred in the recent literature on economic development. While there is clearly a demand for micro loans, and there are many heartening anecdotes about the benefits of microfinance, there has recently been some skepticism about its overall impact. So what in fact can small-scale capital markets contribute and how could we measure it?

Take as an example Grameen Bank, its Nobel Laureate founder making it the poster child of microfinance. Grameen has seven million borrowers in Bangladesh¹ – clearly small relative to the population of potential borrowers. Assume that the bank's operations raise each borrower's income by \$1 per day, a small increase in absolute terms but significant in a country where most incomes are in single figures per day. Then this would generate \$2.5 billion in extra income annually in a country with a GDP of \$242b – roughly a 1% increase, barely noticeable at the aggregate level. In fact it seems very likely that we do not know Bangladesh's GDP to within 1% accuracy.

But in spite of being statistically insignificant, this may still be an important welfare improvement to very poor people. Generalizing this point, the total number of microfinance borrowers is currently 86m world-wide², so that on a global level the scale is still trivial. Perhaps it is not surprising that microfinance

¹ Data from the annual report on Grameen's web site.

² Data from the Microfinance Information Exchange.

does not appear to have revolutionized the process of economic growth – and perhaps this does not mean that we should be skeptical about its benefits.

Environment

We know that environmental services are an important input to the welfare of the poorest of the poor, and that they suffer more from environmental degradation than the rest of society [Dasgupta 2001]. They are seriously vulnerable to climate change and in some areas they are already suffering because of the impacts of climate change on agriculture. The poorest of the poor are also vulnerable to growing water shortages in developing countries, shortages that will probably be exacerbated by a changing climate.

We have come to realize in recent years that poor countries with large forests are subsidizing rich ones because of the role that forests play in the global carbon cycle. The extent of the subsidy could run to tens of billions of dollars annually [Heal 2000]. Recently the international community has agreed to begin paying for the carbon capture and storage services of tropical forests, under the heading of REDD+, or Reduced Emissions from Forest Degradation and Deforestation. This is most important innovation in development finance of last decades, and could generate tens of billions of dollars annually for countries that keep large tropical forests intact.

Technology

One of the most remarkable phenomena in developing countries has been the rise of the cell phone, which is now ubiquitous even in sub Saharan Africa. Better communications raise productivity and welfare [Heal 2008, Waverman et al.] and bring the information age to even the very poor. Cell phones combined with microfinance can also bring financial services to the poorest people in developing countries. It is the low capital costs of cellular technology, much lower than conventional land-lines, combined with innovations in telecom business models, that have driven this growth.

Interestingly, similar possibilities may be opening up with Solar PV panels, whose prices have recently dropped from \$8 to \$1.8 per Watt of capacity. At this price they will be considerably less expensive as a source of electric power than a conventional fossil fuel grid in countries with no grid infrastructure in place. We may see an explosion of off-grid solar power in poor countries over the next decade.

References

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