



# Why is Underdevelopment so Persistent?

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# Why is underdevelopment so persistent?

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- Poor countries don't know!
- Elite domination of political institutions (including military)
  - Elite power enshrined in political institutions
  - Elite prefer greater share of small pie rather than risk losing share while creating a larger pie through better policies
  - Dominant theory of underdevelopment
  - Why follow inefficient economic policies?
  - Why has democracy not had more effect?
  - Zimbabwe? Pinochet?



# Why is underdevelopment so persistent?

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- Elite domination of economic and social institutions
  - Power endogenous
  - Two constituency view
  - Why don't democracies introduce competition or "soak the rich" policies?



# Why is underdevelopment so persistent?

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- Inequality divides
  - Unequal endowments => multiple constituencies
  - Elite domination but also middle and lower class rents
  - No reform path commands majority
  - Pro-elite policies despite democracy
  - Competitive rent preservation!



# Example: Economy with 3 constituencies

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- Monopolist– only firm in town
- Educated middle class
  - Managers, entrepreneurs, doctors, teachers
  - Benefit from not having to compete with poor for jobs requiring education
- Uneducated poor
  - Workers, agricultural laborers
  - Benefit from low cost of services provided by middle class
- Each constituency has one vote



# Two reforms

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- Enhancing access to factor endowments:
  - Universal education
- Enhancing competition:
  - Lower entry barriers into industry



# Status quo is a possibility

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- Middle class want lower barriers to opening businesses
  - More jobs, particularly for educated
- Monopolist does not
- Poor's views depend on whether their access to education expands
  - Substantially more jobs if they are educated
  - Substantially more costs if education does not expand
    - Doctors' fees
- But neither middle class nor monopolist want more education
  - Middle class because their rents are reduced as more poor compete for jobs for educated
  - Monopolist because poor will become middle class, and vote for lower barriers to opening businesses



# Examples of competitive rent preservation

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- China and interior provinces
- India and marketing produce



# Why are countries poor?

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- Initial inequality when colonized
  - Existing structures/populations
  - Technology of production
  - Disease environment
- Inequality persisted and supported policies that entrenched the inequality
  - Land
  - Education
  - Finance
- Example: structure of land holdings in India (Banerjee and Iyer)
- Example: structure of land holdings in US (Erikson and Ramcharan)
- Counterexample to colonial influence: Iyer

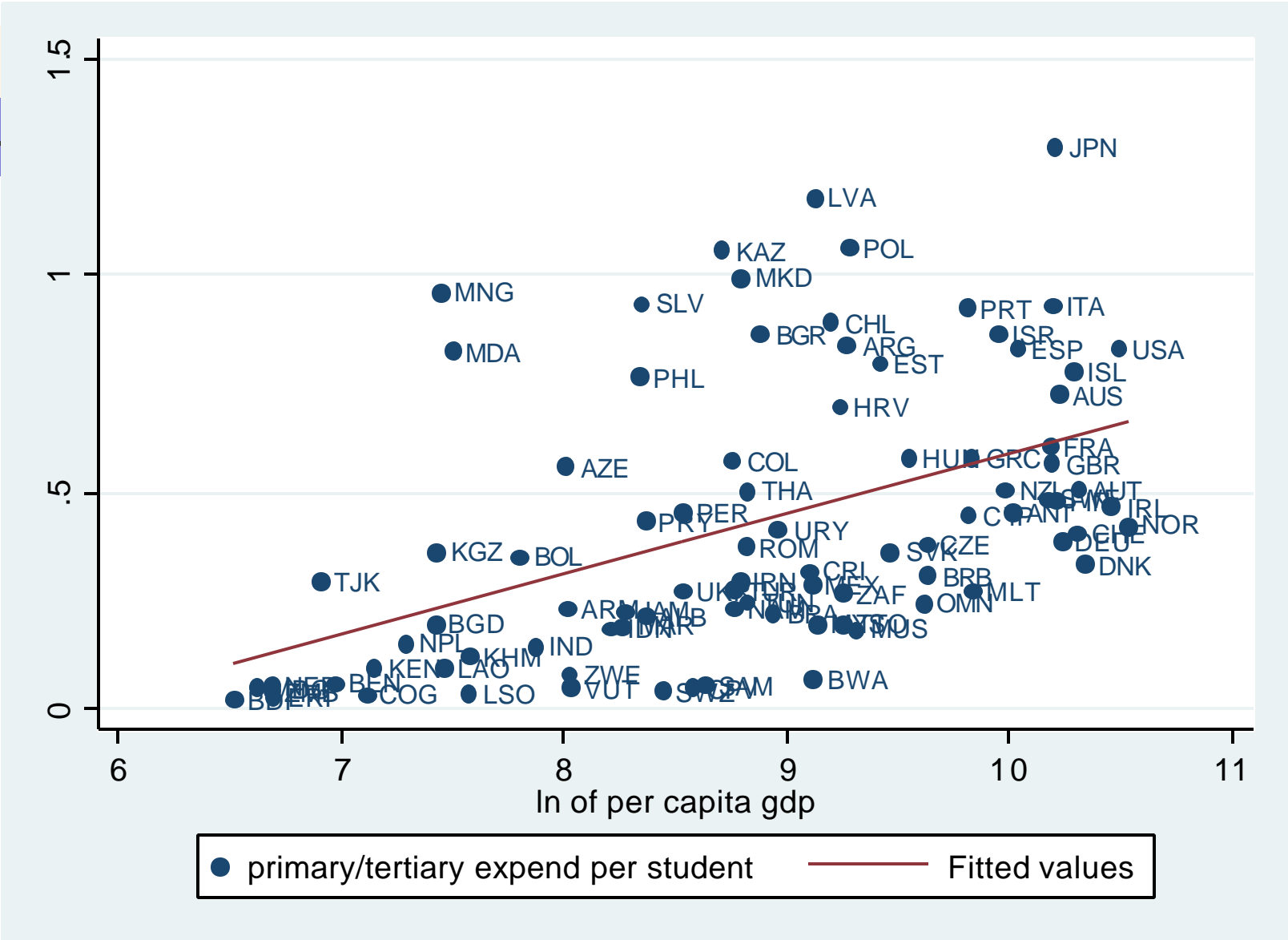
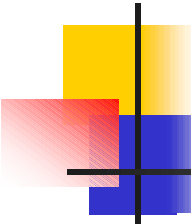


# Some facts from education

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- Ratio of public expenditure per student in primary education to public expenditure per student in tertiary education
- Should be high in poor countries by standard theory
  - Technology
  - Public good aspect
- Should be low in poor countries if problem is unequal access to endowments.
- Suggestive only!!!!

# Primary Tertiary ratio vs Log Per Capita GDP





# Implications

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- Reforms are not a “no-brainer” – not simply a matter of selling it to the poor.
  - No straightforward reform path commands broad support
  - Need to enhance access even while increasing competition
- Sequencing matters
  - Endowment enhancing before competition enhancing. Free access economy before (or together with) free enterprise economy

Allows emphasis on opportunities rather than loss of rents

  - Education
  - Healthcare
  - Finance
- Enlist the middle class
  - Otherwise separate and unequal
  - Targeted subsidies for schools that enroll more of the poor, provided standards met
- Opportunistic reform or reform by stealth
  - Once constituencies fall in place, can develop their own momentum



# Implications

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- Pro-market reforms particularly welcome if also broaden opportunity
  - Expansionary liberalizations rather than defensive (crisis-determined) ones
  - Piggyback on trade: Heckscher Ohlin
- Non economic reasons for reform
  - Nationalism
  - Religion
  - Communism
- External Pressure
  - European Union accession
  - China and WTO
- Political institutions more likely to mirror than cause. Political change, e.g., imposing a constitution, may not always produce the desired results without deep-rooted economic reform.