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The Ingredients of GROWTH

A CLOSE STUDY OF 13 HIGH-GROWTH ECONOMIES SUGGESTS THAT, COUNTER TO SOME RECEIVED WISDOM, POLITICAL LEADERS ARE AN INTEGRAL PART OF CREATING SUCCESSFUL ECONOMIES.

By David W. Brady & Michael Spence | Illustration by Stuart Bradford

In recent decades, many economists have advised governments to stabilize, privatize, and liberalize markets. Economists do know how markets work, and they can often predict how mature market economies will respond to certain events and policies. But developing economies lack both mature markets and the institutions that support them—including institutions that define property rights, enforce contracts, convey prices, and bridge gaps between buyers and sellers. These are precisely the institutions that political leaders must establish and then modify as economic growth introduces new problems and opportunities.

The work of the Commission on Growth and Development tended to confirm that political leaders play pivotal roles in the success—and the failure—of economic development. As detailed in its publication *The Growth Report*, the commission closely examined 13 nations whose gross domestic product (GDP) grew at least 7 percent a year for at least 25 years after World War II. (See “The 13 High-Growth Nations” on p. 36 for more about these countries.) In other words, these economies at least doubled in size each decade.

Although these high-growth countries used different economic models and political structures and had different resources and histories, their governments followed broadly similar paths. Often ushered in by a crisis, new leadership chose a promising economic model and then stabilized the nation long enough to let the economic model take root. The leadership also began to create reliable and accountable institutions that kept politicians focused on citizens' long-term well-being. As growth caused change and created new tensions, the leadership corrected the course of the nation by honing the economic model and tuning institutions to emerging needs while maintaining stability.

Rather than suggesting a single recipe for economic growth, our research reveals that there are different paths to development.[1] In this article, we detail how this view plays out in three high-growth countries and eras: China from 1978 to 2005, Japan from 1950 to 1983, and Korea from 1960 to 2000. As the case of China shows, democracy is not a prerequisite for continuous and impressive growth, though some degree of economic freedom is. Meanwhile, Japan and Korea's export-driven, dominant-party democracy follows a trajectory more typical of booming economies in Asia.

Our model further underscores the importance of government leaders in maintaining economic growth. Swiftly changing nations require leaders who adopt the policy or approach of careful experimentation. By avoiding sudden shifts in policy and balancing progress with caution, these leaders limit the damage of missteps. They "cross the river by feeling for the stones," as the Chinese reformer Deng Xiaoping once recommended.

CRISES AND OPPORTUNITIES

In many of the 13 high-growth cases we studied—as well as in India and Vietnam, two countries that are well on their way to joining the ranks of high-growth nations—a crisis preceded economic expansion. One widespread crisis was dire poverty: The average per capita income of the 13 countries at the start of their growth was less than $1,000, and frequently closer to half that. Other crises were financial, or related to the balance of payments or external debt. Whether financial, social, political, or all three, these crises created conditions where leaders faced fewer constraints on their choices of economic models, their political machinations, and their institutional reforms.

In the wake of crises, many leaders fail to adopt a promising economic model, which is why most nations do not become high-growth economies. In contrast, the leaders who kick-started growth in our sample tended to converge on a similar set of practices. They shifted their economies to exporting products that met global demand while importing global knowledge and technology. They allowed competition. And they encouraged high levels of public- and private-sector investment and savings.

In the case of China, for instance, the crises leading up to dramatic growth included decades of low growth, policy-induced hunger and famine, and the turbulence associated with the Cultural Revolution. Deng, whom Mao Zedong had sent into exile during the Cultural Revolution, arrived in the midst of this deteriorating economic situation. Following Mao's death in 1976, Deng returned to the upper echelons of China's political hierarchy. As the country's paramount leader—an unofficial position that nevertheless held great power—he inherited an economy in serious trouble. But there were important intangible assets created during the first 30 years after the Chinese Revolution of 1949: widespread basic education, the abolition of officially sanctioned caste and class distinctions, and some important rural infrastructure, including a strong tradition of family farming, which led the peasants to de-collectivize spontaneously from below, even before Deng came into power.

Building on these strengths, Deng and his fellow reformers introduced a successful three-step development plan that included market mechanisms in the agricultural sector, importation of knowledge and technology from the global economy, liberalization of trade and investment, various forms of quasi-private ownership, and reforms in education, science, and technology. His new, so-called Wenzhou model (of local economies formed mainly by private businesses) lived side by side with state-owned enterprises or, in the words of Deng, "one country, two systems."

Japan likewise chose a high-growth export model, albeit under very different circumstances. Devastated by losses of population, resources, and pride following World War II, the nation faced starvation in its cities, rampant inflation, currency devaluation, and the halt of industrial production.

Following World War II, the U.S. occupation of Japan resulted in the choice of an open-economy growth strategy that leveraged both global demand and knowledge. Under the United States' influence, Japan instituted a democratic form of government, albeit one

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THE 13 HIGH-GROWTH NATIONS

These countries sustained annual increases in GDP of at least 7 percent for 20 years or more.

Economy	High-growth Period	Per capita income ($US as of 2000) At start	Per capita income ($US as of 2000) In 2005
BOTSWANA	1960–2005	210	3,800
BRAZIL	1950–1980	960	4,000
CHINA	1961–2005	105	1,400
HONG KONG*	1960–1997	3,100	29,900
INDONESIA	1966–1997	200	900
JAPAN	1950–1983	3,500	39,600
KOREA, Republic of *	1960–2001	1,100	13,200
MALAYSIA	1967–1997	790	4,400
MALTA*	1963–1994	1,100	9,600
OMAN	1960–1999	950	9,000
SINGAPORE*	1967–2002	2,200	25,400
TAIWAN, China*	1965–2002	1,500	16,400
THAILAND	1960–1997	330	2,400

*Economies that have reached industrialized countries' per capita income levels.
Source: World Bank, World Development Indicators.

dominated by a single party, the Liberal Democratic Party (LDP). Working closely with a competent bureaucracy and business leaders, the LDP consistently made decisions that promoted growth. These decisions included creating institutions characterized by rule of law, predictability, and incentives to keep politicians focused on citizens' long-term well-being.

The Korean case roughly follows the Japanese model. In 1961, South Korea had not recovered from the effects of the Korean War and was a poor agricultural country still under martial law, because of the North Korean threat. That same year, President Park Chung Hee chose to follow a variant of the Japanese model by using the government to create an open economy growth strategy. The Koreans were less successful in creating a single dominant party that was consistently electable. They did, however, create competitive corporations, a competent bureaucracy, and an educational system capable of teaching how export economies and their necessary institutions worked.

In these three cases, leaders not only chose the right economic models in the midst of considerable turmoil, they also managed *not* to choose the *wrong* models. Leadership, then, appears to matter. Yet until recently, social scientists were not able to demonstrate this seemingly obvious fact. That is because history makes it difficult to disentangle whether a leader really caused change or he just happened to be at the helm of the ship of state when growth took off.

In a recent study, though, economists Benjamin F. Jones of Northwestern University's Kellogg School of Management and Benjamin A. Olken of the Massachusetts Institute of Technology took advantage of history to examine what happens to economies when leaders suddenly die, resign, or are deposed.[2] Across 57 cases of abrupt leadership change, all occurring after World War II, the researchers found that the transition of national leaders indeed affected economic growth. The effects were strongest (both positive and negative) in autocratic settings such as China and Iran, where one or a few leaders had centralized authority.

In democratic settings, however, the change of leaders did not have a statistically significant effect on growth. This may be because the lags between leadership changes and policy shifts are longer in democracies. For example, the reforms that India began in the late 1980s are only now beginning to fuel high growth. Future research will have to determine the validity of the widespread hunch that leaders direct growth in democracies, just as they do in autocracies.

STABILITY

In addition to choosing an economic model capable of delivering growth, leaders have to establish political conditions stable enough to give their economic choices time to bear fruit. Political stability is most needed during the early years of a model's implementation. If the plan is still not working after three to five years, the lack of economic growth and development will tend to cause strategy and policy shifts and sometimes regime change.

There are various ways to build political stability, from staging a military takeover, to crafting one-party states, to forging consensus on economic policy between leading political parties. Many of the leaders in our study sought stability by building a dominant party—a strategy that aligns politicians' goals with those of the economic plan. All economic plans give rise to short-term winners and losers. In nations with single dominant parties, ambitious politicians appeal to the winners who support the new economic model because seats tied to power are more valuable than seats in the minority party. Over time, as the growth economy's wealth increases and spreads, the majority party is able to maintain and even expand its position.

In contrast, politicians in nations with multiple parties, such as those of Latin America, do not have an incentive to support "the plan" because their fate is not tied to it. As growth requires voters to make sacrifices in the short term, politicians can appeal to these short-term losers by criticizing the economic plan and then organizing these groups into a majority. This lack of political support in many cases jeopardizes the economic plan's chances of success.

In China, economic reformers inherited a one-party system: the Chinese Communist Party (CCP). Against this stable political backdrop, Deng Xiaoping was able to overhaul his country's economy despite China's deep ideological distrust of market systems and capitalism. The economic and political crises that China was experiencing gave Deng an opportunity to change course with a reduced level of resistance within the party and the population generally. Deng's "white cat, black cat theory" ignited China's great reform. According to this theory, it does not matter whether a cat is white or black as long as it is good at catching rats—a pragmatic and results-oriented approach.

POLITICAL LEADERS MUST USE THEIR INSIGHT, EXPERIENCE, AND SKILLS TO FIND THE SECOND-BEST CHOICES THAT ARE LEAST DAMAGING TO GROWTH.

Although the stability of the CCP allowed Deng to facilitate economic growth, his government adopted a pragmatic perspective within the CCP and reduced the role of ideology in economic policy. He did this most successfully with the "household responsibility system," which essentially granted private property rights through state lease of lands, though the word "private" was avoided until 1988. The "household responsibility system" effectively increased production in China.

Japan's leaders had to work harder to achieve the political stability they needed for their economic experiment. In 1955, the Liberal, Democratic, and Socialist parties were vying for control of parliament. To increase their clout, the Liberal and Democratic parties—which, despite their names, were the more conservative parties—decided to combine. The resulting LDP went on to win every election from its founding until 1993.

To consolidate its power, the LDP manipulated Japan's voting districts and electoral system. Politicians can and do design districts and electoral systems so that their parties can control the legislature with the support of less than a majority of the electorate. The most obvious way to do this is to create districts that overrepresent dominant-party voters—a practice called malapportionment. During the course of economic development, nations like Japan usually transition from agricultural to industrial economies. To win the loyalty of the rural interests, politicians usually subsidize and overrepresent them at the expense of urban districts. During the period of early growth in Japan, the degree of malapportionment was 2 to 1 rural to urban, according to Hiroyuki Hata, a professor in the Faculty of Law at Hiroshima University. In the later period of development, the mid-1960s, the ratio was still 1.6 to 1.[3]

Another way to maintain single-party dominance is to structure the electoral system to the advantage of the dominant party. In many Asian countries, politicians have achieved this by using an electoral system whereby each voter casts one vote for one candidate in a multicandidate race for multiple offices. The candidates receiving the most votes then fill the posts. This system—called the single nontransferable vote system—makes it difficult for nondominant parties to win elections because they do not have the information necessary to nominate the most competitive candidates for district elections. In Japan, this system helped the LDP repeatedly secure the maximum number of seats possible, according to political scientists Gary Cox of the University of California, San Diego, and Emerson Niou of Duke University.[4]

ECONOMIC GROWTH IS NOT AN END IN ITSELF. BUT IT CAN LIFT PEOPLE OUT OF POVERTY AND DRUDGERY. INDEED, NOTHING ELSE EVER HAS.

Given the importance of political stability in spurring economic development, a purely autocratic absolute monarch might seem to be the right leadership choice for growth. The problem is that autocrats may use their power for purposes other than growth and the long-term benefit of the people, or may choose flawed strategies and then have no brakes to stop them. Although no country currently has an absolute monarch, autocracy is associated with economic growth in a subset of autocratic systems, find Jones and Olken. Their study was not confined to the 13 high-growth economies, but still suggests that the absence of dissent allows leaders' economic choices to take root more quickly. Unbound by tradition, autocratic leaders can also choose from a wider array of economic models, such as an export strategy, an isolationist policy (as in Burma or North Korea), and so on. Some succeed.

At the same time, however, many autocracies perform catastrophically. Having unchecked authority does not mean that autocrats will choose a high-growth economic model. As Jones and Olken's study also shows, the effects of leaders are far stronger (in both positive and negative directions) in more autocratic settings than in more democratic ones.

OPEN INSTITUTIONS

A country whose GDP increases more than 7 percent a year for a decade undergoes dramatic transformation. Growth in China, Japan, Korea, and other nations in our study generated new patterns of ownership, new interest groups, a sizable middle class, and a very wealthy upper class. Farm populations moved to urban areas, often sparking violent protests and strikes. Rising middle classes demanded broader political freedoms to reflect the freedoms that they enjoyed in the marketplace. They also tended to want a voice in governance. The price of labor rose, forcing governments to reconsider their chosen economic models. And increases in wealth empowered previously invisible interest groups to challenge the status quo. In short, out of growth arose—and arise—new challenges and sometimes even new crises.

To respond to these shifting parameters, many leaders of high-growth countries opened up their nation's institutions. This opening up included practices such as introducing transparency, establishing the rule of law, creating a bureaucracy of competent officials who understand global economics, and either allowing new elites into dominant party systems, alternating political parties, or changing political structures altogether. In so doing, leaders signaled to their disgruntled citizens that the regime was changing to accommodate their diverse and increasingly complex interests.

Many leaders also learned to make second-best decisions that traded off growth for the return of stability. These decisions often diverged markedly from the simple formula of "stabilize, privatize, and liberalize," but nevertheless kept the nation's economy on track. To make these choices, leaders had to overcome the natural tendency to resist change. It is difficult, after all, to abandon a successful formula, even after it has outlived its usefulness.

In 1979, for example, rampant poverty in rural areas of China following Mao's Great Leap Forward led Chinese leaders to conclude that the Soviet-style system in place since the 1950s was not improving the Chinese standard of living or closing the gap between China and industrialized nations. In response, Deng let farmers raise more crops than the official quota allowed and then sell their surpluses on the market. Although urbanites protested against the resulting higher prices, letting farmers sell their surpluses increased productivity, enriched farmers, and gave Chinese consumers a more plentiful and diverse food supply. And because farmers at the time represented more than 80 percent of the population, the beneficiaries clearly outnumbered those who were adversely affected.

The CCP also opened its ranks to the new interests that growth created. The economy became market-oriented. Foreign trade became a major vehicle of growth, which led to the creation of Special Economic Zones. Openly contested elections for party positions were now held at the village and town levels.

Japan likewise opened its institutions to accommodate its evolving economy. By the late 1960s, economic growth had generated large retail outlets that were crowding out smaller mom-and-pop operations. Pressured by the newfound competition, the mom-and-pop storeowners formed local organizations and began voting for the Japanese Socialist Party—the opposition to the pro-growth LDP.

Faced with the prospect of losing control in Japan's Diet, the LDP chose Tanaka Kakuei as its prime minister candidate for the 1972 elections. Unlike his predecessors, Tanaka was not part of the University of Tokyo-educated party elite. Indeed, Tanaka had not gone to college at all and had formed his new faction of the LDP against considerable opposition.

Once elected prime minister, Tanaka passed the Large Store Retail Act, which allowed local mom-and-pop organizations to delay, obstruct, and even deny large retailers the store space they need to capture economies of scale. With the support of the mom-and-pops, the LDP dominated Japanese politics for another decade.

The LDP struck a similar deal with farm organizations, which wanted to keep foreign agricultural products out of the country. As a result, Japan had disproportionally high numbers of both farmers and small businesses relative to other developed economies. Although these concessions to agriculture and small business interests were far from economically efficient, they protected Japan's long-range growth for at least a decade (assuming that the success of the Japanese Socialist Party would have hurt economic growth).

The success of Korean economic policy generated an increasing middle class and a large number of college students. By the mid-1980s, many of these college students, middle-class ascendants, and union members were in the streets demanding an end to the autocratic political system and the corruption that went with it. The Korean system had relied on a stacked electoral college that guaranteed victory for the candidate of the Democratic Justice Party (DJP). That institution and the election where General Roh Tae Woo of the DJP was to become the next president was the focal point for those seeking political freedom consistent with economic freedom. Roh Tae Woo, faced with the choice of being elected with 100 percent probability, but with continued protests, instead chose to eliminate the electoral college and to reform the National Assembly elections.

Roh was elected president in a close three-way race. Yet the electoral reforms in the assembly resulted in a loss for his party. Although the reforms first resulted in divided government, they ultimately led to a competitive multiparty democracy in which the parties of the left often have control.

LEADING FOR GROWTH

It is easier to learn something known than it is to invent something new. That is why advanced economies do not grow (and cannot grow) at rates of 7 percent or more, and why lagging economies can catch up. To take an early example: The textile industry of Osaka, Japan, eclipsed the mills of Lancashire, England, by borrowing, assimilating, and improving British designs and techniques. The facade of the Osaka Spinning Company, established in 1883, was even built from imported Lancashire red brick.

As the Chinese, Japanese, and Korean cases demonstrate, leaders of high-growth nations must walk a fine line between accommodating evolving economic and political interests and maintaining some degree of stability, coherence, and persistence in the policy space. Some scholars hold that Western-style democracy is the best form of government for walking that line because it allows leaders to accommodate more interests and follow different frameworks at various points. But the presence of several non-democracies on our list of 13 high-growth economies belies democracy as a critical ingredient for growth. Moreover, other scholars, such as Daron Acemoglu of the Massachusetts Institute of Technology and James A. Robinson of Harvard University, provide intriguing evidence that democracy is more a consequence than a cause of economic growth.[5]

What does emerge as a crucial factor in sustained and rapid growth, however, is leadership. A good economic model, persistently applied in a stable polity, is not enough to secure strong development. But it's a start. As societies grow and change, leaders must continuously adapt political, economic, and institutional structures and interactions without disrupting growth dynamics. This is a huge challenge, as revealed by the rarity of high-growth countries. This challenge falls mainly to political leaders, who must use a combination of insight, experience, and political skill to find the compromises and second-best choices that are least damaging to the growth process.

Support for our view that government leaders are important parts of economic development is not airtight or universal. Our study draws mostly on Asian examples, which are not representative in large part because they had dominant single-party structures for much of the period of their rapid growth.

We also caution that economic growth is not an end in itself. Some leaders, such as India's Jawaharlal Nehru and Mao, placed other priorities above economic development.

But economic growth does make it possible to achieve other important individual and social goals. It can lift people out of poverty and drudgery. Indeed, nothing else ever has. It also creates the resources to support health care, education, and other objectives that many nations and people share. In short, we hold that economic growth is a necessary, if not sufficient, condition for broad development, allowing individuals to be more productive and creative than they would be otherwise. ■

Notes

1 This article is adapted from David Brady and Michael Spence, "Leadership and Politics: A Perspective From the Growth Commission," *Oxford Review of Economic Policy, 25, 2009.*

2 Benjamin F. Jones and Benjamin A. Olken, "Do Leaders Matter? National Leadership and Growth Since World War II," *Quarterly Journal of Economics, 120*, August 2005.

3 Hiroyuki Hata, "Malapportionment of Representation in the National Diet," *Law and Contemporary Problems, 53*, 1990: 157-70.

4 Gary Cox and Emerson Niou, "Seat Bonuses Under the Single Nontransferable Vote System: Evidence from Japan and Taiwan," *Comparative Politics, 26*, 1994.

5 Daron Acemoglu and James A. Robinson, *Economic Origins of Dictatorship and Democracy*, New York: Cambridge University Press, 2005.