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# Executive Summary

It is conventional wisdom that:

- Continued fast growth in the BRICS will result in a rapid catch-up to match and even surpass Western income levels in the next few decades
- The crisis in Europe will soon be over and normal growth will then resume as if nothing had happened
- The tax competition resulting from globalization means a race to the bottom in which corporate tax rates fall dramatically everywhere
- The best way to escape the poverty trap is to give the poor more money
- Losers from globalization can be ignored by politicians in western democracies because they do not matter for electoral outcomes
- The adjustment problems for developing countries arising from the crisis are quite minor and easy to deal with

Actually, as *Reversals of Fortune* shows, all of these beliefs are highly questionable. The research findings reported here provide economic analysis and evidence that challenge these claims.

In Chapter 1, we argue that the 1930s' precedent suggests that policy responses to the crisis in Europe will be damaging to future growth prospects. The legacy of the crisis will probably be increased protectionism and financial repression both of which will impair productivity growth. As a result of the crisis public debt to GDP ratios are at levels which threaten adversely to affect growth. Some of the productivity gains from European integration are jeopardized by problems of the Euro which are unlikely to be resolved quickly. The OECD's current projection that productivity growth in the Euro area will be 1.8% in 2018-30 compared with 1.0% pre-crisis is very optimistic

In Chapter 2, we examine whether and how globalisation has affected individual preferences and attitudes towards market integration, as well as related questions such as immigration and preferences for public spending and redistribution. These changes in preferences do not necessarily have a direct impact on policymaking, but through their effect on individual voting behaviour they determine who will hold office and who will decide about policies. One notable aspect in Western democracies today is the increased importance of extremist and right-wing parties. Chapter 2 attempts to link voter choice for these parties to individual preferences that might have shifted because of globalisation and internationalization of capital and product markets. The analysis of individual preferences with regard to globalisation, redistribution and immigration highlights the fact that incumbent politicians need to take into account the fears of globalisation losers, particularly when deciding on welfare state spending, redistribution, regulation of immigration, and how to deal with the emergence of extremist groups and parties.

In Chapter 3, we examine the institutional and policy responses of governments in western democracies to globalization pressures. Politicians are often faced with trade-offs and having to make difficult choices balancing domestic demands from voters and international pressures that have continued to increase in the era of globalisation. Market integration enhances gains from

trade and overall welfare, but also exerts downward pressures on regulatory and fiscal matters, in addition to generating distributional conflicts. Governments that want to maintain popular support need to develop strategies that are capable of balancing these forces. As this chapter shows, these strategies are not uniform and there is no catch-all or optimal solution for all societies, nor are the domestic and international constraints faced by different countries the same. Indeed, as the analysis in this chapter demonstrates, governments usually pursue different strategies with respect to fiscal responses to globalization and implement a myriad combination of policies that are optimal with respect to electoral success, given a country's institutional and historical context, voter preferences and international pressures – but not necessarily from an economic efficiency or overall welfare point of view.

Chapter 4 asks whether BRIC countries are set to become per capita GDP leaders in the foreseeable future. It argues that, although the BRIC countries may be expected to become larger in terms of GDP, they are unlikely to become per capita GDP leaders in the foreseeable future, since their per capita income levels today are still very low and changes of leadership in per capita income have been rare in history. In fact, although many countries have started on the catching-up path, most have stalled a long way short of the frontier. Policies that help to get growth accelerations started may hinder growth in the later stages of catching-up so that, for example, a country that adjusts its institutions to catching up thanks to industry may struggle to compete in services at later stages of development. Russia is the richest BRIC country today with a per capita GDP of about 30% of the US level. Russia's previous experience of catch-up growth during the Soviet era was followed by a growth slowdown and collapse. The current era of rapid growth has taken place under an authoritarian government which provides only selective enforcement of property rights. China's per capita GDP is about 20% of the US level. Rapid growth has now been sustained over three decades, through a system of regionally decentralised authoritarianism, which has worked well because of competition between provincial leaders. But as China approaches the frontier, further reforms will be needed. India is the poorest BRIC country, with a per capita GDP of around 10% of the US level. Although there are concerns about the level of corruption in India, it is the only BRIC country where success has been driven more by services than by industry. This bodes well for the future, as a key characteristic of many rich countries is their strong performance in the services sector.

Chapter 5 argues that the global financial crisis of 2008 had a dramatic and adverse impact on economic growth across the developed world. The response in the developing world was quite heterogeneous, with some emerging-market countries recovering relatively quickly and others suffering from a prolonged recession. The chapter emphasizes the importance of a country's political institutions in determining the speed of this policy response and economic adjustment. It further stresses that there are no one-size-fits-all recipes that can be suitable for every developing country. The analysis emphasizes the importance of policy experimentation and learning in shaping the trajectory of economic development. Given that such experimentation needs time it is important that countries develop good institutions of conflict resolution. This will help leaders buy time to experiment and to avoid taking a myopic view when crafting the optimal policy response to an economic shock.

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Chapter 6 considers ways to alleviate chronic poverty in developing countries and asks what are the origins of self-reinforcing mechanisms, or “poverty traps,” that cause poverty to persist? In economics a significant strand of research focuses on external constraints that may perpetuate poverty traps, such as lack of credit or insecure property rights. From this starting point pro-poor policies tend to focus on relaxing the external constraints. More recently, economic research has learned from ideas that emphasize constraints internal to the person that also perpetuate poverty, for example learned helplessness, pessimistic beliefs, and an external locus of control. Unlike the external constraints, these internal constraints are endogenous because they adapt to the experience of the condition of chronic poverty. Over time, however, they become an independent source of disadvantage for poor persons in their own right. Pro-poor policies that take into account the need to alter internal constraints among the poor will have a greater impact on poverty alleviation than policies that address external constraints alone. An example is raising the aspirations of poor people. Ongoing CAGE fieldwork documents the impact of “dream-building” sessions (pioneered by the Durbar Foundation) to empower a marginalised, stigmatised community of sex workers in Kolkata and change their behaviour.

## The authors

**Sascha O. Becker** is Professor of Economics at the University of Warwick and the Research Director for CAGE. He obtained his PhD from the European University Institute, Florence, in 2001. His main fields of research interest are education and labour economics, public economics and economic history.

**Stephen Broadberry** is Professor of Economic History at the London School of Economics and a Research Theme Leader at CAGE. He obtained his DPhil from Oxford in 1982. His main fields of research interest are economic history and economic growth.

**Nicholas Crafts** is Professor of Economics and Economic History at the University of Warwick and Director of CAGE. His main fields of research interest are the comparative economic performance of European economies and the economic geography of industrialisation.

**Sayantana Ghosal** is Professor of Economics at the University of Warwick. He was Research Director for CAGE from 2010 to 2012 and is now a key researcher at CAGE with a strong involvement in Theme 3, Poverty and Wellbeing. He obtained his PhD from CORE, Université Catholique de Louvain in 1995. His field of research is economic theory and its applications, including general equilibrium models, modelling internal constraints and deprivation, financial crises and long-run growth.

**Sharun W. Mukand** is Professor of Economics at the University of Warwick and Research Theme Leader at CAGE. He obtained his PhD from Boston University in 1998. His main areas of research interest are the political economy of globalisation and development, with a focus on the political economy of policymaking.

**Vera E. Troeger** is Professor of Quantitative Political Science at the Economics Department and the Department for Politics and International Studies at the University of Warwick and is Research Associate at CAGE. She obtained her PhD from the Max Planck Institute of Economics and the University of Konstanz in 2006. Her research interests lie at the intersection of international and comparative political economy, econometrics, and applied statistics.