

# PROJECT SYNDICATE

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## BUSINESS & FINANCE



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# In Search of Convergence

CAMBRIDGE – One puzzle of the world economy is that for 200 years, the world's rich countries grew faster than poorer countries, a process aptly described by Lant Pritchett as “Divergence, Big Time.” When Adam Smith wrote *The Wealth of Nations* in 1776, *per capita* income in the world's richest country – probably the Netherlands – was about four times that of the poorest countries. Two centuries later, the Netherlands was 40 times richer than China, 24 times richer than India, and ten times richer than Thailand.

But, over the past three decades, the trend reversed. Now, the Netherlands is only 11 times richer than India and barely four times richer than China and Thailand. Spotting this reversal, the Nobel laureate economist Michael Spence has argued that the world is poised for *The Next Convergence*.

Yet some countries are still diverging. While the Netherlands was 5.8, 7.7, and 15 times richer than Nicaragua, Côte D'Ivoire, and Kenya, respectively, in 1980, by 2012 it was 10.5, 21.1, and 24.4 times richer.

What could explain generalized divergence in one period and selective convergence in another? After all, shouldn't laggards grow faster than leaders if all they have to do is imitate others, even leapfrogging now-obsolete technologies? Why didn't they grow faster for so long, and why are they doing so now? Why are some countries now

converging, while others continue to diverge?

There are potentially many answers to these questions. But I would like to outline a possible explanation that, if true, has important implications for development strategies today.

The economic expansion of the last two centuries has been based on an explosion of knowledge about what can be made, and how. An apt metaphor is a game of Scrabble: Goods and services are made by stringing together productive capabilities – inputs, technologies, and tasks – just as words are made by putting letters together. Countries that have a greater variety of capabilities can make more diverse and complex goods, just as a Scrabble player who has more letters can generate more and longer words.

If a country lacks a letter, it cannot make the words that use it. Moreover, the more letters a country has, the greater the number of uses it could find for any additional letter it acquired.

This leads to a “quiescence trap,” which lies at the heart of the Great Divergence. Countries with few “letters” lack incentives to accumulate more letters, because they cannot do much with any additional one: you would not want a TV remote control if you didn’t have a TV, and you would not want a TV broadcasting company if your potential customers lacked electricity.

This trap becomes deeper the longer the alphabet and the longer the words. The last two centuries have seen an explosion in technologies – letters – and in the complexity of goods and services that can be made with them. So the techies get techier, and the laggards fall further behind.

Why, then, are some poorer countries now converging? Is the technological alphabet getting shorter? Are products getting simpler?

Obviously not. What is happening is that globalization has split up value chains, allowing trade to move from words to syllables. Now, countries can get into business with fewer letters and add letters more parsimoniously.

It used to be that if you wanted to export a shirt, you had to be able to design it to the taste of people you didn’t really know, procure the appropriate materials, manufacture it, distribute it through an effective logistical network, brand it, market it, and sell it.

Unless you performed all of these functions well, you would go out of business. Globalization allows these different functions to be carried out in different places, thereby allowing countries to participate earlier, when they still have few locally available capabilities, which can then be expanded over time.

A recent example is Albania. Known as the North Korea of Europe until the early 1990s, when Albania abandoned its quixotic quest for autarky, it started cutting and sewing garments and shoes for Italian manufacturers, gradually evolving its own fully integrated companies. Other countries that started in garments – for example, South Korea, Mexico, and China – ended up reusing the accumulated letters (industrial and logistical capabilities) while adding others to move into the production of electronics, cars, and medical equipment.

Consider this a stylized version of the sale of IBM's Thinkpad to China's Lenovo. Once upon a time, IBM asked a Chinese manufacturer to assemble its Thinkpad – using the components that it would supply and following a set of instructions – and send the final product back to IBM.

A couple of years later, the Chinese company suggested that it take responsibility for procuring the parts. Later, it offered to handle international distribution of the final product. Then it offered to take on redesigning the computer itself. Soon enough, it was no longer clear what IBM was contributing to the arrangement.

Learning to master new technologies and tasks lies at the heart of the growth process. If, while learning, you face competition from those with experience, you will never live long enough to acquire the experience yourself. This has been the basic argument behind import-substitution strategies, which use trade barriers as their main policy instrument. The problem with trade protection is that restricting foreign competition also means preventing access to inputs and knowhow.

Participating in global value chains is an alternative way to learn by doing that is potentially more powerful than closing markets to foreign competition. It enables a parsimonious accumulation of productive capabilities by reducing the number of capabilities that need to be in place in order to get into business.

This strategy requires a highly open trade policy, because it requires sending goods across borders many times. But this does not imply laissez-faire; on the contrary, it requires activist policies in many areas, such as education and training, infrastructure,

R&D, business promotion, and the development of links to the global economy.

Some dismiss this strategy, arguing that countries end up merely assembling other people's stuff. But, as the famous astronomer Carl Sagan once said: "If you want to make an apple pie from scratch, you must first invent the universe."

*<https://www.project-syndicate.org/commentary/ricardo-hausmann-asks-why-growth-rates-are-converging-among-some-countries-and-diverging-among-others>*

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