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Charles van Marrewijk , Steven Brakman , Julia Swart
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The Economics of Developing and Emerging Markets

This textbook presents an innovative new perspective on the economics of development, including insights from a broad range of disciplines. It starts with the current state of affairs, a discussion of data availability, reliability, and analysis, and an historic overview of the deep influence of fundamental factors on human prosperity. Next, it focuses on the role of human interaction in terms of trade, capital, and knowledge flows, as well as the associated implications for institutions, contracts, and finance. The book also highlights differences in the development paths of emerging countries in order to provide a better understanding of the concepts of development and the Millennium Development Goals. Insights from other disciplines are used to help understand human development with regard to other issues such as inequalities, health, demography, education, and poverty. The book concludes by emphasizing the importance of connections, location, and human interaction in determining future prosperity.

Charles van Marrewijk is Professor of Economics and Department Head of Utrecht University School of Economics. He has studied, worked, and/or taught in the Netherlands, the United States, China, Australia, Russia, and the Philippines. Charles is (co-) editor for three journals and has published widely in top journals on economic development, growth, migration, trade, comparative advantage, inequality, location, foreign direct investment, urbanization, resilience, transfers, and so on. He has also published more than 10 books for Cambridge University Press and Oxford University Press and is probably best known for his work in geographical economics and a spiky world (with Steven Brakman and Harry Garretsen).

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Preface

Most people in the world are poor. If we knew the economy of being poor, we would know much of the economics that really matter.

Theodore Schultz (1981, p. 3)

Title of the Book and Terminology

One of the most central questions in economics concerns why some nations become rich and others stay poor. This is the focus of one of the most famous books in economics: *An Inquiry into the Nature and Causes of the Wealth of Nations*, by Adam Smith. The current textbook tackles the same question and demonstrates what has been learned since the publication of Smith's famous work in 1776. However, it focuses largely on the developing world because, in these countries, the problem of staying poor is not simply a matter of lagging behind: it is a matter of extreme poverty, and this makes the answer to the question incredibly urgent.

This book is entitled *The Economics of Developing and Emerging Markets*. This understandably raises the question: What are developing and emerging markets? The answer is not simple. The quote from Schultz, above, suggests that it is about poverty, and it is. But it is about much more than that. Today, the average person in Macao earns about 160 times more per year than the average person in Burundi. That is already an enormous difference, but it gets worse. Male life expectancy in Burundi today is around 59 years, compared to roughly 81 years in Macao. So in terms of lifetime earnings, the difference is around 220 times as high. In addition, income inequality is high in Burundi. According to the World Income Inequality database (https://wid.world/data/), the poorest half of the population earn about 15 percent of all income, which is the same as the figure shared by the richest 1 percent of the population. For the bottom half in Burundi, the lifetime earnings ratio relative to the average person in Macao has now risen above 700. And it seems to be getting worse over time: in 2002, the average income level in Macao was only 65 times higher than in Burundi, compared to today's 160 times.

As shown throughout this book, many issues play a role in poverty and development, including health, education, the environment, trade flows, uncertainty, capital accumulation, agricultural transition, institution building, firms, demography, urbanization, and the environment. The existence of reliable datasets on these phenomena is one of the big changes compared to the days of Adam Smith, and this hugely increases the knowledge of

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economic development. As this textbook shows, all these issues are highly correlated with levels of income per capita. Since reliable income data is available for most countries, it is used as a benchmark in most of the analyses. The terms "North" and "South" have been used in the past to describe advanced and poor countries respectively, but this is geographically incorrect: various countries in the south have high income levels and some countries in the north have low income levels. It was also customary at some stage to use numbers: First World (Western Europe and North America), Second World (Communist Bloc of the Soviet Union and China), and Third World (all other countries). This system became obsolete over time.

It is now customary to use the term "developing countries" to refer to poorer nations, suggesting that it is a matter of time before these countries can deal with their development problems. It is not viewed as a derogatory term, as all countries are developing in one way or another.

Many authors use the term "developed countries" to differentiate from developing countries, but this has three disadvantages. First, it is a static term, suggesting that developed countries have reached some end point and stop developing. Second, it is a derogatory term relative to developing countries, many of which in certain aspects of human development and cultural finesse reach higher levels of development than some "developed" countries. Third, the terms "developing" and "developed" are too similar, which can easily cause confusion.

For these reasons, the terms "developing" and "advanced" are used throughout this textbook when referring to countries. The difference in sound and looks leads to clarity, and being advanced also implies there is still room for improvement. The focus here is on being economically advanced – not necessarily advanced in other areas. (To distinguish between developing and economically advanced countries would be too cumbersome, however, so developing and advanced are used for brevity.) The authors apologize in advance to anyone who may be offended in some way.

Development is a dynamic and relative term, depending on time and with whom the comparison is made. The focus in this textbook is the world as a whole, so countries are usually compared to all other countries for which data are available. The figure below is an illustration. Since countries can be large or small in terms of land area, population, and income. These differences are also taken into consideration, for example, by comparing to the world average or relative to the size of the population.

Figures – and for that matter, tables – are often used to demonstrate a point. Much can be learned from a good figure or table. What can be learned from this figure, for example? And, importantly, when should caution be exercised when drawing conclusions from figures like the Preface Figure? Take a moment to inspect it. Note that the situation is compared regarding incomes per capita of 1995 (horizontal axis) and 2019 (vertical axis).

- First, the figure could show that a country is emerging if it moves from the low to the middle category. This method would imply that four countries (China, Armenia, Sri Lanka, and the Philippines) have been emerging from 1995 to 2019.

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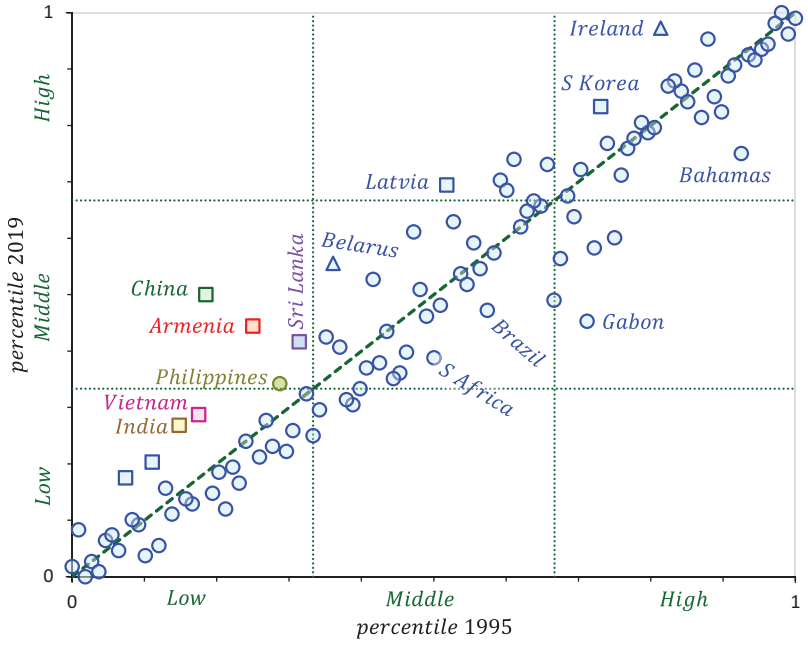

Figure 0.1 Income per capita; percentile ranking, 1995 and 2019
Source: Created using World Development Indicators online.
Notes: Income per capita is GNI PPP in constant 2017 $; 109 countries included; dashed line is diagonal; dotted lines at one-third and two-thirds; squares have long-run growth above 4 percent; triangles have percentile rise above 0.15.

- Second, it could show that a country has to have a high growth rate for a significant time period to be classified as emerging. The average longer-term compounded growth rate from about 1990 to 2019 for 154 countries is 2.0 percent. So the figure could show that a country is emerging if its growth rate is above 4.0 percent over a period of 20 years or more. There are nine countries that meet this criterion, identified by a square symbol. The Philippines would no longer qualify, but the other countries above are joined by Vietnam, India, Cambodia, Bangladesh, Latvia, and South Korea.
- Third, the figure could show that a country is emerging over some time period if its percentile ranking rises sufficiently fast. Suppose an increase of 0.15 or more is required. Five countries meet this criterion, namely Armenia, China, and Latvia, as well as Belarus and Ireland (identified by triangles).
- Fourth, the figure could show that a country is emerging if it meets all three requirements above, in which case only Armenia and China would qualify.

Each method above has its disadvantages. The first method fails to identify rapidly developing countries like India and Vietnam. The second method avoids this problem, but also identifies more advanced countries, like South Korea, which should no longer be thought of as emerging. The third method avoids arbitrary cut-off lines, but includes advanced countries like Ireland and countries that do not perform spectacularly, but rise in the rankings because countries in their distribution range do poorly, like Belarus. The fourth method is too restrictive. Perhaps the second criterion in combination with the

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requirement that it is a low- or middle-income country initially would be most appropriate. It would identify eight countries: Cambodia, Bangladesh, India, Vietnam, China, Armenia, Sri Lanka, and Latvia.

The main goal of the textbook is that you, based on evidence that is provided in the literature and based on available data, and after studying the material in this book, can form your own informed opinion of what is important in the development process of countries.

Overview of the Book

Many issues play a role in determining a country's competitiveness, and hence its level of economic development. This textbook delves deep into most of them. It does so in four main parts divided into 19 chapters, outlined briefly below.

Part I: Introduction and Deep Roots

Part I consists of four chapters to provide an introduction to economic development and an analysis of deep roots. Chapter 1 focuses on the current state of economic development in the world, with a discussion of global regions, land area, population, income level, trade flows, and competitiveness. Chapter 2 evaluates data and methods, with a discussion of the reliability of data sources, an overview of statistics, the importance of creating graphs, and a review of regressions and main problems, and methods to deal with these problems. Chapter 3 starts the *deep roots* discussion on the (initial) main (biogeographic) causes of differences between countries and regions in the level of economic development. It takes us to the origins of life on Earth and human development, with an emphasis on the importance of the *Agricultural Revolution* for creating the conditions for building institutions and more rapid economic growth. Chapter 4 concludes the deep roots discussion by emphasizing the role of geographic-human interaction for properly understanding the evolution and shifts in economic development. It focuses on the role of incorporated institution building in migration flows in relation to geo-human interaction to properly understand these effects.

Part II: Human Interaction

Part II consists of five chapters and shifts focus from geo-human interaction to human interaction, which becomes relatively more important as time progresses. Chapter 5 provides an overview of globalization and economic development from a longer-run perspective (2,000 years). The chapter covers different types of globalization, price wedges, and trade-, migration-, and capital flows. Chapter 6 focuses on a better understanding of the causes and consequences of trade flows between nations. It covers comparative advantages based on differences in technology and factor abundance, as well as competitive advantages related to intra-industry trade flows, imperfect competition, and firm heterogeneity.

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Chapter 7 continues with an overview of the main causes of economic growth and development based on (human) capital accumulation, total factor productivity, knowledge flows, and endogenous growth, as well as the dynamic costs of trade restrictions. Chapter 8 analyzes institutions and contracts, with a discussion of the nature of the firm, social costs, property rights, and the relationship between institutions and economic development (do institutions cause growth?). Chapter 9 concludes, outlining money and finance issues, with a particular focus on exchange rates, forward markets, interest parity, the policy trilemma, and the links between finance, investment, and development.

Part III: Human Development

Part III consists of five chapters with a focus on important aspects of human development. Chapter 10 opens, with a discussion on measuring poverty and the speed of its decline, as well as gender equality, and measuring income inequality with an overview of recent changes, both globally and within and between countries. Chapter 11 introduces *poor economics*, which attempts to better characterize and understand the economic lives of the poor and the decisions they make. This approach uses randomized control trials as its main methodology, briefly discussed in terms of advantages and disadvantages and applied in other chapters. Chapter 12 analyzes population and migration issues by discussing developments in world population, birth rates, death rates, and population pyramids. The impact of demographic transition is then linked to present and future demographic dividends. Problems of migration in terms of refugees and internally displaced persons can be big, but are usually small relative to the demographic forces analyzed previously. Chapter 13 focuses on the importance of education for economic development by discussing the biology of learning and the links with development. The chapter addresses the gender gap in education and the quality of university and basic skills education before discussing a teaching model on tracking students, peer effects, and teacher payoffs (which is then taken to the data). Chapter 14 concludes with a discussion of health issues, including life expectancy, its links with development, differences in health care, and a characterization of the main causes of death. The chapter includes an evaluation of infant-, child-, and maternal mortality, before discussing two health experiments on deworming and providing school meals.

Part IV: Connections and Interactions

Part IV also consists of five chapters and focuses on connections and interactions between different parts of the development process. Chapter 15 opens with a discussion of agriculture in connection with (rural) development by reviewing agricultural production and employment in an historical perspective in relation to the Lewis model of development. After an evaluation, the chapter continues with a discussion of development in the agricultural sector, before concluding with agricultural policies. Chapter 16 evaluates the rising importance of location for economic development by analyzing the role of urbanization and agglomeration in the development process, both from an historical perspective and more recently. Chapter 17 continues in this spatial direction by discussing regularities

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(Zipf's Law and the Gravity Equation) in a geographical economics framework with multiple equilibria and path dependence. A discussion in a broad historical perspective emphasizes the rising importance of human interaction over time, while building on geo-human interaction, as noted above. Chapter 18 discusses firm heterogeneity and focuses on the rising importance of multinational firms for economic development. It provides an overview of empirical regularities before explaining the Melitz model, which helps to understand horizontal and vertical foreign direct investment (fragmentation). The chapter reviews the links with (wage) inequality and concludes with a discussion of measuring supply chains. The book concludes in Chapter 19 with a discussion of sustainability in connection with development and the environment by analyzing scale, competition, and technology effects, and multilateral agreements and the natural resource curse, as well as the main differences between renewable and nonrenewable natural resources.

Authorship

Charles van Marrewijk has authored or co-authored all chapters in this book.
Steven Brakman has co-authored Chapters 9, 15, 16, 17, and 18 of this book.
Julia Swart has co-authored Chapter 19 of this book.

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