

Introduction: Re-examining Long-run Growth: Insights from Case Studies

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This book reports the main results of the Global Development Network's Global Research Project on 'Explaining Growth'.¹ The project was undertaken in two phases. The first phase consisted of regional analyses of various determinants of long-run growth, including sources, microeconomic determinants, market behavior and political economy, for seven regions spanning the developing and transition world.² A summary and cross-regional thematic analysis of these studies is available in McMahon and Squire (2003), and the approach and main results of Phase One are summarized in Chapter 1 of this book. In addition to standing as significant contributions in their own right, the regional studies were designed to provide background and a framework for the case studies of 53 developing countries and 25 transition economies undertaken in the second phase of the project. Each of these case studies analyzes the main factors facilitating or inhibiting the country's long-run growth over the last 20–50 years or the country's growth during the transition.

Two features of the project warrant mention. First, 'Explaining Growth' recognizes that there may be many paths toward growth, some leading to faster and broader attainment of sustainable prosperity than others, depending on a country's conditions. A thorough understanding of the history of growth – and a prognosis of prospects for the future – must therefore be grounded in the specific context of each country. Second, the project thus relies almost exclusively on local researchers, those with the expertise and knowledge to understand the specifics of each country. It is an integrated yet decentralized project, implemented by researchers from every corner of the developing world.

These two features – an emphasis on context-specificity and reliance on local expertise – led naturally to the project's use of case studies as the vehicle of analysis. Indeed, one of the most important findings of the first phase of this project was the potential of case studies. Cross-country studies and regional analyses are able to shed considerable light on important determinants of

long-run growth, but more in-depth country-level studies are necessary to determine the political, societal and cultural interrelationships which affect growth patterns (McMahon and Squire 2003, 29). While conventional, cross-country regression analysis looks at individual determinants of growth across a large number of countries, the case-study approach undertaken in Phase Two of this project allows us to look at combinations of factors within countries. Moreover, there is no presumption of a universal growth path. While it may be possible to identify a group of factors which are common to all countries with strong long-run growth, some or all of which are absent from poor or weak performers, it is just as likely – if not more likely – that strong long-run growth may be feasible with different combinations of factors. Even if there is a predominant set of growth-related factors, their presence may not guarantee growth in all countries. As this book makes clear, context matters. More fundamentally, identifying a predominant set of growth-related factors says nothing about how those factors came into being. Again, the case studies address these issues.

For each of the case studies, the authors divided the years from approximately 1950 to 2000 (post-1990 for the transition economies) into different periods, each distinguished by an important turning point in the country's growth history. For each period, the researchers presented the initial conditions, including the institutional and policy heritage and political interest groups. Next, they analyzed the behavior of agents, including their response to any exogenous or endogenous shocks; the interaction between agent behavior and policy and institutional changes; the growth outcome of each period and any important changes in institutions, policies and political interest groups; and any important changes in other indicators of development, such as poverty, income distribution, health and education. The authors then reported the main results of the period analysis, emphasizing which factors of production were most important for explaining aggregate growth, and the policies and institutions which helped or hindered the accumulation or efficient use of factors of production. They also discussed future prospects for aggregate growth in the country and offered policy and institutional recommendations.

Given the large number of country studies, no attempt has been made to provide individual summaries of all of them.³ Rather, the authors attempt to summarize the results in two ways. First, two of the chapters present overviews of the main results. Thus, Chapter 1 reports the results of the first phase, summarizing the accompanying book, while Chapter 9 undertakes the same task for the second phase. The other chapters present summaries of the case studies for each of seven regions: East Asia, South Asia, Latin America and the Caribbean, Middle East and North Africa, Central and Eastern Europe and

the Commonwealth of Independent States. The remainder of this Introduction provides a reader's guide to the book's nine chapters.

Chapter 1 by Hadi Salehi Esfahani reports the results of Phase One, highlighting key points which guided the conduct of the case studies and also laying the foundation for the conclusions presented in the volume's final chapter. He first discusses the standard quantitative analysis – growth accounting and cross-country regressions – undertaken to place each country in regional and global perspective. Among the interesting results is the tendency for high investment rates and high total factor productivity (TFP) growth rates to co-exist, suggesting that once the 'right' conditions are in place investors and innovators alike have the confidence to risk capital (human and physical) in pursuit of high returns. The question is, of course, what are the 'right' conditions. Here the econometric literature provides some guidance, but in practice different sets of variables, different definitions of the 'same' variable, different specifications, and so on, yield different results. This, in turn, suggests that the conventionally used variables are often insufficiently well defined to capture the intended or expected contributions to growth of the factors – like institutions or policies – they are supposed to measure, and that a common specification for all countries fails to encapsulate the differences in their individual histories, contexts and circumstances, underscoring the rationale for an approach based on detailed case studies. Three other results reported in Chapter 1 are of special importance for the conclusions drawn in Chapter 9.

First, Chapter 1 focuses on political economy and, in particular, the negative impact of incomplete contracting on long-run growth, especially where there is inadequate representation and significant divergence in the preferences of key economic agents and decision-makers (Sub-Saharan Africa and Middle East and North Africa). In contrast, strong governments which have been able to coordinate policies to serve broad interests have achieved sustained growth (East Asia). This observation paves the way for a key point developed in Chapter 9 – countries face a basic political constraint; namely, if growth is not forthcoming and if the benefits are not widely or reasonably distributed because of the inadequacy or self-interest of the decision-making authority, whether democratic or totalitarian, then that authority will eventually be overthrown, peacefully or violently. According to this interpretation, *broad-based* growth is necessary for *sustained* growth.

Second, the results indicate that socioeconomic systems are complex and dynamic, and circumstances, technology, external factors and resource availabilities are in constant flux. Sustainable rapid growth thus places a huge premium on the decision-maker's ability to respond to changing conditions, including failed policy experiments. Ideological rigidity rarely serves the

interests of long-run growth. The transition economies of Central and Eastern Europe are one example of a response to a major shock, but responsiveness and self-correcting policies, rather than an ideologically driven manifesto, have also distinguished the fast-growing countries of East Asia from their counterparts in Sub-Saharan Africa, that became mired in the extremes of an inflexible socialist philosophy.

Finally, the studies reflect the definitional problems encountered in the econometrics literature. Commonly used measures for institutional factors often capture only an aspect of the function which is the subject of real interest. Moreover, even formally similar institutional arrangements may generate different results in different countries. Again, context matters. Once the focus of attention is shifted squarely to the *functions* particular institutions are expected to perform – research and development, contract enforcement, rule of law, accounting standards, corporate governance, corruption control, competition policy, labor market regulation, and so on – rather than their outward appearance or statistical approximation, then governments may be able to find and implement substitutes for the more formal versions observed in the developed world. Rule of law, contract enforcement, and so on as known in the industrialized countries may take considerable time to develop, but other, more easily introduced instruments may fill the gap at least temporarily, even if they are only imperfect substitutes. Thus, public investment may substitute for some commitment deficiencies, or aggressive export-promotion policies may offset weaknesses in domestic contractual and enforcement arrangements.

These three points – the elemental political constraint, responsive, self-correcting policymaking and simple, but imperfect, substitutes for institutional and administrative capacity – play an important role in Chapter 9's interpretation of the growth experience recounted in the case studies.

In Chapter 2, Peter Warr comments that studying the successful East Asian countries is important, because while there are limitless ways of failing, there are presumably fewer paths to success. With this as motivation, Warr points to the 'advantages of backwardness' implied by the hypothesis of 'conditional convergence'; after all, the East Asian countries were some of the poorest in the world in the 1950s. They were therefore well-placed to take advantage of the technological advances pioneered by others, as were other underdeveloped countries. What allowed the East Asian countries to realize this growth 'catch-up' when others failed to do so? While Warr stresses that there is no single East Asian model, he highlights five common factors: macroeconomic discipline, sustained TFP growth, human resource development, economic openness and high domestic savings. Through these means, and in line with the interpretation provided in Chapter 9, these countries provided a reasonably secure and supportive environment for investment and, at the same time, met the

elemental political constraint of providing broad-based benefits. This outcome reflected the authorities' recognition of its importance to their prospects for staying in power, whether democratic or authoritarian, and in turn ensuring the stability, security and widely distributed public services which encourage savers, investors and innovators alike to commit resources to future growth in a virtuous circle.

Turning to South Asia, per capita income grew at a rate of 2.5 per cent for the 45 years from 1960 to 2005. This commendable performance is often overlooked, as Siddiq Osmani reminds us in Chapter 3, and it is, in fact, second only to East Asia. What is most extraordinary about this performance, however, is that South Asia was the slowest growing region in the developing world from 1960 to 1980. Indeed, South Asian growth can be divided into three subperiods, roughly the 1950s and 1960s, the 'dismal decade' of the 1970s and the revival of growth after 1980. In his summary, Osmani notes the commonalities in the timing of the three sub-periods and in the corresponding policy changes across countries, but at the same time he stresses that the country-specific stories differ in key ways – such as the civil war in Sri Lanka and the breakup of Pakistan in 1971 – and should therefore be regarded as distinct experiences, albeit with some common factors at play.

Soon after independence, all countries in the region emphasized industrialization based on a strategy of import substitution. This proved reasonably successful until the end of the 1960s and resulted in the establishment of a recognizable industrial sector in the larger countries, especially in India. The 'dismal decade' followed, roughly covering the 1970s. The limits of import substitution may have to shoulder part of the blame, but the spread of extensive and comprehensive state intervention in almost all spheres of economic activity surely played a major role. The egalitarian appeal of socialism as espoused by Indira Gandhi in India, ZulfikarAli Bhutto in Pakistan, Srimavo Bandaranaike in Sri Lanka and Sheikh Mujib in Bangladesh swept the region. Ideology governed economic policy and the resulting state-dominated economies proved too rigid to respond to the shocks – especially the oil price shock of 1973 – which hit hard during the decade. The responsiveness and pragmatism in policymaking stressed in Chapter 9 was thus missing until the 1980s (early 1990s for Bangladesh), when country after country embarked on expansionary macroeconomic policy which provided a growth spurt, as excess capacity from the dismal decade was brought back into operation. The spurt was solidified, however, by wide-ranging liberalization. Bangladesh, for example, engineered one of the most dramatic trade liberalizations anywhere in the developing world, reducing the unweighted rate of protection from 73 per cent in 1991–92 to 28 per cent in 1995–96.

The shift from market to state and back to market evident in the South Asian experience is also observed in Latin America, as described by Gary McMahon in Chapter 4. This region, with the notable exception of Chile, achieved growth spurts only after both the shift to state-based development and the subsequent shift to a more market-based approach. Most Latin American countries pursued policies of import substitution in the first or second decade after World War II, with some realizing good growth performances at least until the first oil shock in 1973. Indeed, Brazil realized an annual per capita rate of growth of 4.76 per cent from 1950–76, peaking at 6.81 per cent during its ‘economic miracle’ from 1968 to 1976. During the 1970s, import substitution ran into the limits imposed by small domestic markets. Perhaps more important, the rents generated by this approach became entrenched, making it difficult to realign policies quickly and effectively in the face of the major external shocks of the 1970s. Since domestic capitalists and organized labor were the main beneficiaries of those policies, the uneven distribution of income was exacerbated, paving the way for distributional conflicts.

Necessary reforms were delayed during the lost decade of the 1980s, due to the uncertainty regarding probable outcomes – especially their distributional consequences. As McMahon notes, the political institutions were not well equipped to cope with these economy-wide conflicts, as their experience was mainly with respect to rewarding the groups in power and their main supporters. In an extreme case, failure to recognize the political constraint of ensuring a broad-based distribution of benefits led to the overthrow of President Alfredo Stroessner of Paraguay in 1989. More generally, while the market-oriented reforms gradually introduced between the mid-1980s and the mid-1990s did lead to a growth spurt, probably reflecting the renewed use of idle capacity, they suffered from inadequate attention to the institutional framework necessary for their long-run success and failed to inspire an increased rate of investment. As the spurts sputtered to an end, the reforms were called into question because of their failure to deliver broad-based benefits. The exception, Chile, had attended to institutional matters including such basics as placing the authority for initiating economic policy in the executive branch, essentially the Ministry of Finance, in the 1980 Constitution and legislating independence of the Central Bank in 1989, thereby freeing economic policy to deal with the distributional conflicts outside the political arena and to respond speedily to external shocks.

The results in the Middle East and North Africa share some features with Latin America, especially the reasonably strong rates of growth up to 1980, but the region suffered a more marked and longer-lasting slowdown thereafter. Hadi Salehi Esfahani’s discussion of the region in Chapter 5 points to the underlying differences across countries, especially the ready availability of resource rents which came directly, as in the oil-exporting economies, or indirectly through

official transfers and remittances, as in most of the others. The ‘social contract’ which emerged in these circumstances reflected both the availability of these rents and the demand for their redistribution, and it essentially took the form of significant state intervention, more so than in Latin America, through trade restrictions, mass subsidies, price and quantity controls, public ownership and public investment in education, healthcare, infrastructure and manufacturing. The interventions, as observed in other regions, vary across countries. In the republics, where the pre-existing power relationships had been fractured by military coups, revolutions or national liberation movements, the new political elite saw a need for redistribution to secure broad support. The monarchies, where rulers benefited from the support of traditional alliances, were less preoccupied with redistribution to the masses and more willing to support the private sector.

Whatever the degree of redistribution, and it was substantial in all countries through subsidies, government employment and public investment, the approach nevertheless fostered growth at least through 1980. The absence of any of the institutions required to support an exclusive reliance on free markets in the 1950s and 1960s, and the recognition that such institutions require time to develop, pointed to the choice of state-led development. For a time the approach succeeded, but by the 1980s the higher levels of income and education led to new social, political and economic demands at a time when the per capita availability of external resources and the governments’ ability to meet those demands was declining. Governments responded with an approach akin to the Chinese-style ‘dual track’ strategy, in which market signals were freed up in some segments of the economy while the government maintained control in others mainly through public ownership and employment. The approach constitutes a balancing act between the continuation of the past policies of redistribution and new departures intended to foster growth, such as export promotion. However, reconciling the two proved difficult, and progress was at best checkered, because the management of the political constraint in the region was more about redistribution of resource rents than broad distribution of gains from growth, as evident in the riots against subsidy reform in Egypt (1977), Jordan (1989) and Morocco (1985). Countries with limited access to resource rents, such as Tunisia, generally fared better, as trade liberalization created a political force to counterbalance the influence of those benefiting from the old protectionist policies. Egypt, on the other hand, benefited from increased inflows of foreign aid, tourism revenue and remittances which undermined the need to push the ‘private sector’ component of the dual track, and growth has been correspondingly less rapid.

Sub-Saharan Africa has had the lowest growth rate in the developing world since 1960. But, as Augustin Fosu and Ernest Aryeetey note in Chapter 6,

performance should properly be described as episodic with strong growth – 5 per cent a year – in the decade and a half after 1960, then becoming negative in per capita terms for most of the following 20 years, before moving to between 3 and 4 per cent in the second half of the 1990s. Following independence, most – if not all – countries in the region were in a similar position as their counterparts in Asia, but, unlike the high-growth economies of East Asia, they failed to reap the ‘advantages of backwardness’, while embracing an even more rampant brand of socialism than the countries of South Asia and opting for inward-looking, state-led strategies in an attempt to establish their national identities. Tanzania, for example, espoused ‘African Socialism’ in the 1967 Arusha Declaration, and many other countries followed a similar doctrine to varying degrees. The absence of the institutions and infrastructure essential for a market-based approach undoubtedly limited the range of feasible options and, at least for a decade and a half, the government-led strategy yielded satisfactory output growth, as it had in Latin America.

The approach, however, placed extraordinary power in the hands of the executive, but with few of the checks-and-balances underpinning governance in the developed countries. As discussed in Chapter 9, policymakers can be thought of as conducting an implicit cost-benefit analysis when they come to power. At one extreme, the government may aim for broad-based growth, and, if successful in meeting this basic political constraint, it will remain in power. Botswana followed this path. At the other extreme, the goal may be little short of maximum looting, as happened under Mobutu Sese Seko in the Democratic Republic of Congo (1973–97), Idi Amin in Uganda (1971–79) and Sani Abacha in Nigeria (1993–98). Unfortunately, the rent-seeking opportunities implicit in the state-led strategy enticed many policymakers toward the Idi Amin end of the spectrum rather than the Botswana end. Other factors contributed. Ethnic considerations influenced many investment decisions which benefited the Tutsis in Burundi (1975–87), the Temnes in Sierra Leone (1969–90), the Kabeyes in Togo (1976–90) and so on. In addition, positive supply shocks put enormous amounts of resources in the hands of keen-to-spend central governments (oil in Nigeria in the 1970s), while negative ones (drought) often led to an intensification of state control.

In the 1990s, the political constraint became binding in a host of countries. Burundi, the Central African Republic, Comoros, DR Congo, Djibouti, Liberia, Niger, Rwanda, Sierra Leone and Togo all experienced severe political instability and, more often than not, armed conflict because of the failure to achieve growth and ensure an acceptably egalitarian distribution of its benefits. Elsewhere, governments undertook – with varying degrees of willingness – structural adjustment programs supported by the Bretton Woods Institutions. While there are bright spots – Ghana, Uganda – results have been

disappointing, with deindustrialization occurring in many countries (probably inevitable given past investment mistakes) and little sign of a resurgence in investment. Nevertheless, per capita growth has been restored in the second half of the 1990s.⁴

Chapter 7 (East and Central Europe) by Jan Fidrmuc, Mark Chandler and Julius Horvath and Chapter 8 (Commonwealth of Independent States) by Gur Ofer and Richard Pomfret examine the transition economies and the extent to which their experience with the switch from state-led to market-led development sheds light on the efforts to place more reliance on markets as a path to growth in developing countries more generally. While countries in both regions had to move away from the shackles of central planning, differences between the two have been described as the 'great divide'. Thus, the East and Central European countries have benefited from their past interaction with Western Europe and their ongoing integration into the European Union. In these countries, the extent of the required transition was less than among the CIS, and entry into the EU 'enforced' basic policy standards and the creation, or recreation, of the institutional infrastructure required by a market economy. In consequence, they experienced shorter periods of transition, as evidenced by the resumption of growth (3 to 4 per cent at the start of the new century), the restructuring of trade toward the West and inflows of FDI, a good indicator of the quality of institutional arrangements.

Ofer and Pomfret draw a sharp distinction between the physical base and the institutional base at the start of the transition in the CIS. They point out that the model of 'extensive growth' pursued under the Soviet Union had resulted in a large industrial sector, supportive transport and supply networks and a respectable stock of human capital. True, their economies were characterized by over-industrialization (cf. the de-industrialization, albeit on a much smaller scale in Sub-Saharan Africa) and misaligned infrastructure once the new structure of incentives was in place, but this pales in comparison with the need for institutional transition. The authors start with Douglass North's distinction between formal and informal institutions. With formal institutions, all production and transaction decisions in a command economy are made at the top, implemented through the specification of quantities of inputs and outputs, and enforced by means of coercion and strict discipline, the exact opposite of a market system. With informal institutions, the collection of behavioral norms and the culture of doing business which typically underpin formal institutions in a market economy became a sort of release valve in the CIS which, while introducing a much-needed degree of flexibility, provided a vehicle for corruption, bribery and all other forms of non-productive, self-serving behavior. For these reasons, the required institutional transition was massive. Thus, just when the weaknesses of the newly emerging markets

warranted more government intervention, the value of such interventions was most in doubt. The authors conclude that, while the slow reformers are losing steam, the big bang versus gradualism debate was misplaced, in that the focus should have been, and should still be, on the task of building new institutions, a protracted process at best and one that is still incomplete in the CIS.

Drawing the threads together of a project which emphasizes context-specificity and diversity runs the risk of simply restating the basic point that context matters, without contributing any additional insights about the growth process. In synthesizing the results of the project in Chapter 9, Esfahani, McMahon and Squire do indeed stress the importance of context, especially when the powerful role of political economy in determining growth outcomes is recognized, as it should be. In line with this emphasis, the authors steer clear of simplistic, generalizations of the factors required for growth – the ‘what’ of the growth process – which has dominated the econometrics literature and led to endless debates about the relative contributions of initial conditions, policies, institutions, geography, culture and so on. A context-driven approach inevitably, but unsatisfactorily, concludes that all can be important to varying degrees in various circumstances. To go beyond this truism, the authors draw conclusions about the *process* of growth. In particular, they point to three attributes of the process which seem to be associated with sustained growth or can contribute to it: elemental political constraint; responsive, self-correcting policymaking; and simple but imperfect substitutes for institutional and administrative capacity.

The case studies illustrate well the extent to which the key decision-making authority varies in different countries, ranging from a unique individual with autocratic control, through a group exerting power with the support of a single ruling party, to a democratically elected government. They also demonstrate that the different types of decision-makers have different goals, ranging from self-enrichment to national well-being, although there is no simple correlation between types and goals. Nevertheless, whatever the form of the decision-making authority, and whatever the goals they pursue, all are subject to an elemental political constraint: the population at large must experience the benefits of growth if the authority is to remain in power. For a while, and it can be a long while, small elite groups can capture the rents at the cost of the majority or at the cost of growth, but eventually the voice of the majority will be heard through the electoral process in a democratic context or through public protests, revolutionary movements, or, in non-democratic contexts, civil war. The success stories in East Asia achieved broad-based growth and remained in power. Many countries in Sub-Saharan Africa have suffered armed conflicts precisely because growth has been non-existent or unevenly distributed. It is

this observation which leads to the conclusion that *broad-based* growth is a prerequisite for *sustained* growth.

Decision-makers have highly imperfect information regarding the effects of policy, both in a pure economic sense and in a political sense. Nobody knows *ex ante* how particular policies will impact the economy or the distribution of income. Nobody knows how far the political constraint can be pushed before it becomes binding. But everybody knows circumstances will change, unanticipated shocks – internal and external – will occur, new technologies will appear and the unforeseen will happen. Given the complexity and dynamism of the world, and our imperfect understanding of how it works, ideological rigidity will, eventually, prove disastrous, whereas pragmatism and responsiveness to changing conditions and to ineffective policy initiatives are more likely to sustain growth, as illustrated by the East European economies before and after the break-up of the Soviet Union.

Our final remark brings us back to our starting point – context matters. The case studies (and the analysis of Chapter 9) illustrate time and time again the futility of seeking to identify a unique set of factors required for growth. Chapter 9 shows that three sets of factors, falling under the broad headings of signals, security and support, commonly associated with growth in the literature are indeed present in some of the fast-growing countries in our sample, but they are absent from other fast-growers and present in some of the slower growing ones! While the basic requirements of sound macroeconomic policy must always be met, many of the institutional arrangements considered essential for growth – contract enforcement, rule of law, impartial courts and open markets – are missing from some fast-growers or else are present in some of the slow-growers. This observation leads to the emphasis on the functions of institutions rather than their outward manifestation or the quantitative indicators conventionally used to measure them (see also Rodrik 2005). This, in turn, opens the possibility of finding unconventional substitutes to fill critical gaps, while more formal institutions are being developed. Possibilities emerging from the case studies include public investment, aggressive export promotion policies and industrial policy. Carried too far, such policies may do more harm than good and can lead to rent-seeking behavior, but well-managed interventions, as in Korea since the 1960s and China and Tunisia since the 1980s, may offer an important means of boosting growth in the medium-run, while laying the foundations for future institutional development.

NOTES

1. The Global Research Project grew out of a regional project on growth in Sub-Saharan Africa, organized by the African Economic Research Consortium.
2. In five of the regions – East Asia, South Asia, Latin America and Caribbean, Middle East and North Africa and Sub-Saharan Africa – the research examined long-run growth. The project also looked at growth during the transition in two other regions, Central and Eastern Europe and the Commonwealth of Independent States.
3. Many of the country studies have been published in edited volumes. See Fernández-Arias, Manuelli and Blyde (2006), Nugent and Pesaran (2007) and Ofer and Pomfret (2004). All of the studies are accessible on line at the Global Development Network's website, www.gdnet.org.
4. In the 2000s many Sub-Saharan African countries have had good-to-high growth due to high commodity prices, particularly minerals, but it is too early to tell whether this will lead to sustained growth.

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