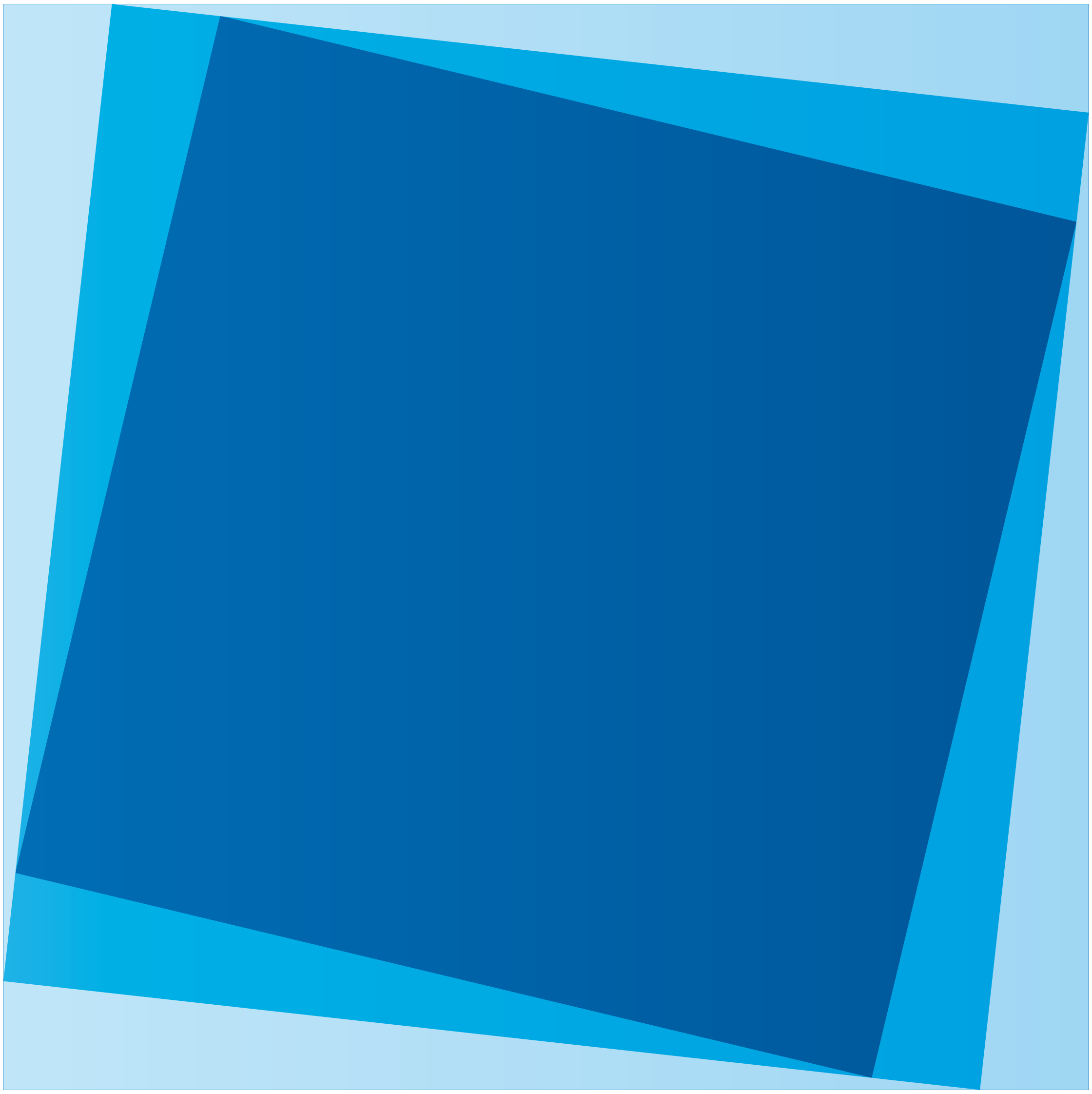
Towards a New Enlightenment? A Transcendent Decade



The Past, Present and Future of Economic Development

Nancy H. Chau y Ravi Kanbur

Nancy H. Chau
Cornell University

Nancy H. Chau is Professor of Economics in the Charles H. Dyson School of Applied Economics and Management. Professor Chau's research interests fall under three main areas: international trade, regional economics, and economic development. Professor Chau was recently awarded the Alexander von Humboldt Research Fellowship, and the first T. W. Schultz Award of the International Agricultural Economics Association. She is a senior fellow at the Center for Development Research, a research fellow at the Institute for the Study of Labor (IZA Bonn), and member of an expert panel for the Office of the UN High Commissioner for Human Rights. Professor Chau has published widely, in journals such as *Economic Journal, International Economic Review, Journal of Development Economics, Journal of Economic Growth, Journal of Economic Theory, Journal of Labor Economics, Journal of Public Economics, Journal of Public Economic Theory* and the *World Bank Economic Review*.

Ravi Kanbur
Cornell University

Ravi Kanbur researches and teaches in development economics, public economics, and economic theory. He is well known for his role in policy analysis and engagement in international development. He has served on the senior staff of the World Bank, including as Chief Economist for Africa. He has also published in the leading economics journals, among which *Journal of Political Economy, American Economic Review, Review of Economic Studies, and Journal of Economic Theory and Economic Journal*. The positions he has held or holds include: President of the Human Development and Capabilities Association, Chair of the Board of United Nations University-World Institute for Development Economics Research, Co-Chair of the Scientific Council of the International Panel on Social Progress, member of the OECD High Level Expert Group on the Measurement of Economic Performance, President of the Society for the Study of Economic Inequality, Member of the High Level Advisory Council of the Climate Justice Dialogue, and Member of the Core Group of the Commission on Global Poverty.

Recommended book: *Contributions to the Economics of International Labor Standards*, Arnab K. Basu and Nancy H. Chau, World Scientific Publishing Co., 2017.

This overview considers the past, the present, and the future of economic development. It begins with the conceptualization, definition, and measurement of economic development, highlighting that a narrow focus on the economic is inadequate to capture development and even, paradoxically, economic development itself. Key aspects of economic and human development over the past seven decades are then outlined, and the current landscape is described. The paper then considers the future of economic development, highlighting the challenges faced by developing countries, especially the opportunities and risks provided by the recent downward global trend in the share of labor in overall economic activity.

What is economic development and how has the concept evolved through the years? The economic part of it could be thought to be relatively straightforward. Surely, a steady rise in per capita income as conventionally measured is an anchor, in concept and in reality. It would be odd indeed to describe declining per capita income as economic development. But rising per capita income, while necessary, is certainly not sufficient for development, and even for economic development.

The distribution of this rising income among the population is legitimately in the domain of economic development. Two key features of the distribution of income are inequality and poverty. If average income rises but the inequality of its distribution also increases, then an egalitarian perspective would mark down the latter as a negative aspect of economic development. If poverty, the population below a socially acceptable level of income, also increases then this is another negative mark to be set against rising average income in assessing economic development. Of course, the actual outcome on poverty will depend on an interaction between average income and inequality and which of the two forces dominates empirically.

If higher average income is accompanied by increasingly unequal distribution, an egalitarian perspective will qualify it as negative. Growing poverty would also contrast negatively with highter average income in any evaluation of economic development

But identifying economic development purely with income is too narrow a conception. Other aspects of well-being are surely relevant. Education and health outcomes, for example, go beyond income. They are important markers of well-being in their own right, but they influence, and are influenced by, income. High income can deliver an educated and healthy population, but an educated and healthy population also delivers high income. Thus, any assessment of development, and even economic development, needs to take into account a broader range of measures of well-being than simply income and its distribution. Education and health, and their distribution in the population, are important as well.

Distribution is not simply about inequality between individuals. Inequality across broadly defined groups is also a key factor. Gender inequality saps economic development as it suppresses the potential of half the population. Thus, improvements in measures of gender inequality are to be looked for in their own right, but also because of the contributions they make to economic growth and to addressing economic inequality. Similarly, inequalities between ethnic and regional groups stoke social tension and affect the climate for investment and hence economic growth. It is difficult to separate out these seemingly non-economic dimensions from the narrowly economic. Economic development is thus also about development more generally.

A narrow focus on measured market income misses out on use of resources which are not priced appropriately in the market. The most important of these is the environment, especially in the context of greenhouse gas emissions and climate change. Rising national income as conventionally measured does not price in the loss of irreplaceable environmental resources at the national level nor, in the case of climate change, irreversible moves toward catastrophic risks for the planet we live on.

A broader conception of development has been embraced by the international community, first through the Millennium Development Goals (MDGs) of 2000, and then through the Sustainable Development Goals (SDGs) of 2015. The eight MDGs were expanded and modified to seventeen SDGs, which include conventional economic measures such as income growth and income poverty, but also inequality, gender disparities, and environmental degradation (Kanbur, Patel, and Stiglitz, 2018). Indeed, the crystallization and cementing of this broader conceptualization of development, and even of economic development, has been one of the sure advances during the past decade of thinking, and surely represents a move toward a "new enlightenment" in assessing trajectories of achievement. But what have these trajectories been over the past seven decades since World War II? The next section takes up the story.

The Past[1]

The six decades after the end of World War II, until the crisis of 2008, were a golden age in terms of the narrow measure of economic development, real per capita income (or gross domestic product, GDP). This multiplied by a factor of four for the world as a whole between 1950 and 2008. For comparison, before this period it took a thousand years for world per capita GDP to multiply by a factor of fifteen. Between the year 1000 and 1978, China's income per capita GDP increased by a factor of two; but it multiplied six-fold in the next thirty years. India's per capita income increased five-fold since independence in 1947, having increased a mere twenty percent in the previous millennium. Of course, the crisis of 2008 caused a major dent in the long-term trend, but it was just that. Even allowing for the sharp decreases in output as the result of the crisis, postwar economic growth is spectacular compared to what was achieved in the previous thousand years.

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But what about the distribution of this income, and in particular the incomes of the poorest? Did they share in the average increase at all? Here the data do not stretch back as far as for average income. In fact, we only have reasonably credible information going back three decades. But, World Bank calculations, using their global poverty line of $1.90 (in purchasing power parity) per person per day, the fraction of world population in poverty in 2013 was almost a quarter of what it was in 1981—forty-two percent compared to eleven percent. The large countries of the world—China, India, but also Vietnam, Bangladesh, and so on—have contributed to this unprecedented global poverty decline. Indeed, China's performance in reducing poverty, with hundreds of millions being lifted above the poverty line in three decades, has been called the most spectacular poverty reduction in all of human history.

But the story of the postwar period is not simply one of rising incomes and falling income poverty. Global averages of social indicators have improved dramatically as well. Primary school completion rates have risen from just over seventy percent in 1970 to ninety percent

By 2013 the percentage of the world's population living in poverty had dropped to one fourth the percentage of 1981: eleven percent compared to the previous forty-two percent

A fishermen's neighborhood in Mumbai, where the suburbs are changing their appearance thanks to an organization dedicated to improving living conditions for the disadvantaged in India's financial capital. June, 2018

The international community adopted a more global concept of development through the 2000 Millennium Development Goals (MDG)

The opening session of the Millennium Summit at United Nations Headquarters in New York on September 6, 2000. From left to right: the then Secretary General of the UN, Kofi Annan and co-presidents Tarja Halonen (Finland) and Sam Nujoma (Namibia) now as we approach the end of the second decade of the 2000s. Maternal mortality has halved, from 400 to 200 per 100,000 live births over the last quarter century. Infant mortality is now a quarter of what it was half a century ago (30 compared to 120, per 1,000 live births). These improvements in mortality have contributed to improving life expectancy, up from fifty years in 1960 to seventy years in 2010.

Focus on just income, health, and education hides another major global trend since the war. This has truly been an age of decolonization. Membership of the UN ratcheted up as more and more colonies gained political independence from their colonial masters, rising from around fifty in 1945 to more than 150 three decades later. There has also been a matching steady increase in the number of democracies with decolonization, but there was an added spurt after the fall of the Berlin Wall in 1989, when almost twenty new countries were added to the democratic fold. To these general and well quantified trends we could add others, less easily documented, for example on women's political participation.

With this background of spectacular achievements at the global level, what is to stop us from declaring a victorious past on human progress? The answer is that we cannot, because good global average trends, although they are to be welcomed, can hide alarming counter tendencies. Countries in Africa which are mired in conflict do not have any growth data to speak of, and indeed any economic growth at all. Again in Africa, for countries for which we have data, although the fraction of people in poverty has been falling, the absolute number in poverty has been rising, by almost 100 million in the last quarter century, because of population growth.

A similar tale with two sides confronts us when we look at inequality of income in the world. Inequality as between all individuals in the world can be seen as made up of two components. The first is inequality between average incomes across countries—the gap between rich and poor countries. The second is inequality within each country around its average. Given the fast growth of large poorer countries like India and China relative to the growth of richer countries like the US, Japan, and those in Europe, inequality between countries has declined. Inequality within countries displays a more complex picture, but sharp rises in inequality in the US, Europe, and in China and India means that overall within-country inequality has increased. Combining the two, world inequality has in fact declined overall (Lakner and Milanovic, 2016). The importance of between-nation inequality has fallen from a contribution of four fifths of global inequality a quarter century ago. But its contribution is still not lower than three quarters of total world inequality. These two features, rising within nation inequality in large developing countries, and the still enormous role of between-nation inequality in global inequality, are the other side of the coin from the good news of developing country growth on average in the last three decades.

Inequality among Earth's inhabitants comprises two elements: the first, which is expressed by each country's average income, reflects the gap between rich and poor countries; the second reflects inequalities within each country in terms of average incomes

But income growth, if it comes at the expense of the environment, mis-measures improvement in human well-being. Particulate pollution has increased by ten percent over the last quarter century, with all of its related health implications. The global population under water stress has almost doubled in the last half century, and there has been a steady decline in global forest area over the same period. Global greenhouse gas emissions have increased from under 40 gigatons equivalent to close to 50 gigatons in the last quarter century. On present trends global warming is projected to be around 4°C by 2100, well above the safe level of 1.5°C warming. The consequences of global warming have already begun to appear in terms of an increase in severe weather outcomes.

Thus, the past seven decades have indeed been golden ones for economic development on some measures, and even development more broadly measured. But all is not golden. The trends hide very worrying tendencies which have begun to surface in terms of their consequences, and are shaping the landscape of development we have with us. The next section takes up the story with a focus on the present of economic development.

The Present

The present of the economic development discourse is, of course, shaped by the trends of the distant and recent past. An interesting and important feature of the current landscape is the shift in the global geography of poverty. Using standard official definitions, forty years ago ninety percent of the world's poor lived in low-income countries. Today, three quarters of the world's poor live in middle-income countries (Kanbur and Sumner, 2012). The fast growth of some large countries, accompanied by rising inequality in these countries, means that the average income increases have not been reflected in poverty reduction to the same extent. So, although these countries have now crossed the middle-income category boundary, which depends on average income, they still have large absolute numbers of poor people. These poor in middle-income countries vie with the poor in poor countries for global concern and attention.

This disconnect between a person being poor and their country being poor is shaking up the global development assistance system, which was built on the notion that the bulk of the world's poor lived in poor countries. This is manifested in the "graduation" criteria used by most aid agencies, whereby aid is sharply reduced and then cut off when a country's average income crosses a threshold, typically related to middle-income status. It raises the question posed by Kanbur and Sumner (2012): "Poor countries or poor people?" The response has been, by and large, to stay with the average income criteria. This has led to and will increasingly lead to a dichotomy between very poor countries, often mired in conflict, and middle-income countries where, in fact, the bulk of the world's poor now live. Thus, if the World Bank's soft loan arm sticks to its graduation criteria, it will in effect disengage from the vast majority of the world's poor, while focusing on the poorest countries in the world. This disengagement is difficult to justify on ethical grounds, but also difficult to understand if middle-income countries are also the source of global environmental problems and, for some of them, the source of conflict-based migration.

Migration, conflict-based and economic, brings us to another important feature of the present landscape of economic development, one which is the result of past trends and which will surely have global implications for the future. Rising inequality in rich countries has intersected with increased migration pressures from poor countries. Despite the closing of the gap between rich and poor countries because of the fast growth of some poor countries, the gap is still enormous, both on average and especially so for the poorest countries who have not grown as fast. These gaps have combined with increased pressures because of armed conflict and exacerbated by environmental stress.

Ben Bernanke, president of the United States Federal Reserve between 2006 and 2014, lecturing undergraduate seniors at Harvard University, Cambridge, Massachusetts, in June 2008

The hollowing out of the middle class in rich countries has coincided with greater immigration, leading to a toxification of democratic politics in these countries and the rise of far-right, nativist, and xenophobic tendencies in the body politic (Kanbur, 2018). The election of Trump, the vote for Brexit, and the entry of Alternative für Deustchland into the German Parliament are only the most obvious outward manifestations of the current malaise of the body politic. Nor is this just an issue in rich countries. The anti-migrant mob violence in South Africa and ethnic conflict in countries such as Myanmar are part of the same pattern of migration tensions which color economic development today.

The current terrain of economic development has clearly been influenced by the great financial crisis of 2008. Most recently, the global crisis has proved disruptive to development gains, although the losses can be said to have been mainly concentrated in the rich countries. But the reactions and the backlash now apparent in rich countries are having and will have consequences for economic development in poor countries. Further, the genesis of the crisis exposed fault lines in the economic model pursued by rich countries, with wholesale deregulation of markets and especially of banking and capital flows.

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The current state of affairs and ongoing debates relate back to the trajectory of thinking since the fall of the Berlin Wall in 1989. It will be recalled that in a famous statement of the time the events were characterized as marking "the end of history" (Fukuyama, 1989), meaning by this that liberal democracy and free markets had won the battle of ideas. But, as noted by Kanbur (2001), "the end of history lasted for such a short time." The financial crisis of 1997, emanating from the newly liberalized capital markets of East Asia, was a warning shot. The financial crisis of 2008, emanating in the deregulated financial markets of the US and Europe, led to the world global depression since the 1930s.

The world as a whole is only just recovering from this catastrophe. Its effect on economic thinking has been salutary. Queen Elizabeth II of the United Kingdom famously asked British economists why they did not see it coming. The response from Timothy Besley and Peter Hennessy was that: "So in summary, Your Majesty, the failure to foresee the timing, extent and severity of the crisis and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole" (quoted in Kanbur, 2016). But the risks to the system as a whole were magnified by the deregulatory stance of policy makers in the early 2000s, still basking in the "end of history" narrative of the turn of the millennium. It is to be hoped that the lessons of the devastating crisis of 2008 will not be forgotten as we go forward.

Thus the crisis of 2008 sits atop, and sharpens, negative aspects of trends identified in the previous section and shapes the present and future prospects. These future prospects are taken up in the next section.

The Future

The past and present of economic development sets the platform for the long-term future. Environmental degradation and climate change will surely worsen development prospects and ratchet up conflict and environmental stress-related migration. The issues here have been well debated in the literature (see for example, Kanbur and Shue, 2018). And the actions needed are relatively clear—the question is rather whether there is the political will to carry them out.

Beyond challenges that arise due to ecological change and environmental degradation, another prominent challenge that has arisen since the 1980s is the global decline in the labor share. The labor share refers to payment to workers as a share of gross national product at the national level, or as a share of total revenue at the firm level. Its downward trend globally is evident using observations from macroeconomic data (Karabarbounis and Neiman, 2013; Grossman et al., 2017) as well as from firm-level data (Autor et al., 2017). A decline in the labor share is symptomatic of overall economic growth outstripping total labor income. Between the late 1970s and the 2000s the labor share has declined by nearly five percentage points from 54.7% to 49.9% in advanced economies. By 2015, the figure rebounded slightly and stood at 50.9%. In emerging markets, the labor share likewise declined from 39.2% to 37.3% between 1993 and 2015 (IMF, 2017). Failure to coordinate appropriate policy responses in the face of these developments can spell troubling consequences for the future of economic development. Indeed, the decline in labor share despite overall economic progress is often seen as fuel that has fanned the fire of anti-immigration and anti-globalization backlashes in recent years, threatening a retreat of the decades-long progress made on trade and capital market liberalization worldwide.

It should be noted that the labor share and income inequality are inextricably linked. Indeed, the labor share is frequently used as a measure of income inequality itself (for example, Alesina and Rodrik, 1994). Understanding the forces that determine the labor share has been a singularly important aspect of the landscape of economic development. Indeed, this quest has guided trade and development economics research for decades, during which time the forces of globalization and its many nuanced impacts on the labor share have been fleshed out (Bardhan, 2006; Bourguignon, 2017).

Yet, there are good reasons to take the view that canonical economic models often do not offer predictions consistent with the current pattern of labor share decline in the global economy. Notably, behind the veil of global labor share decline is in fact a tremendous amount of underlying diversity in the direction of change of the labor share at the country level, with emerging and advanced economies at both ends of the spectrum (Karabarbounis and Neiman, 2013). Such observations are contrary to the canonical prediction of economic models based on the assumptions of constant technologies, perfect competition, and no market imperfections. Guided by these assumptions, the standard prediction is that workers in relatively labor abundant countries should strictly benefit from exposure to world trade in both absolute terms and relative to owners of other inputs of production. In stark contrast, however, after taking on the role as the world's largest factory, China has experienced one of the most significant rates of decline in labor share since 1993 (IMF, 2017).

A search for additional forces that may be in play is clearly warranted.[2] To this end, the trajectory of the global labor share sits at the confluence of three major shifts in the defining features of developing and developed economies. These include: (i) the adoption of labor-saving technological change; (ii) the shift in importance of employer market power; and (iii) the growing prevalence of alternative modes of employment in the labor market.

Labor-saving technological change is a key driver in the recent global labor share decline

(IMF, 2017). The reasons for firms and producers to embrace such a change are many, including a reduction in the price of investment goods and informational technology investment (Karababounis and Neiman, 2013), and the advent of robotics in the manufacturing process (Acemoglu and Restrepo, 2018), for example. Already, advanced economies do not have a monopoly over the adoption of labor-saving technological change. Indeed, China has put in place more robots in manufacturing than any other country according to recent estimates (Bloomberg News, 2017). The implication of labor-saving technological change on labor income is not obvious, however, as it juxtaposes the overall productivity gains that arise from the use of labor-saving technical change, with its potential adverse consequences on unemployment. In the end, whether workers benefit from labor-saving technological change will depend on how quickly productivity gains translate into wage gains (Acemoglu and Autor, 2011; Acemoglu and Restrepo, 2018; Chau and Kanbur, 2018).

An important problem arose in the 1980s: the worldwide decline in the workers' payment as a share of gross national product on a national level, or as a share of total revenue at the firm level

It is here that additional research can potentially reap significant dividends in furthering our understanding of how developing country markets function and how they respond to shocks. Some important mediating factors have already been identified. These include existing labor market distortions that may skew decision-making about technological change (Acemoglu and Restrepo, 2018), and search friction in the labor market and the resulting possibility of complex distributional responses to technological change (Chau and Kanbur, 2018). Further, policy responses to labor-saving technical change need to be developed and implemented, including perhaps public investment in research into developing efficient labor using technology (Atkinson, 2016; Kanbur, 2018).

In addition to national- or market-level differences in the labor share, recent firm-level evidence has inspired a surge in studies showing that employer market power can give rise to systematic differences in the labor share across firms with heterogeneous productivity levels (for example, Melitz and Ottaviano, 2008). It is by now well known that globalization disproportionately favors high-productivity firms. The ascendance of superstar firms in recent years in the US, with their demonstrably higher propensities to adopt labor-saving technologies, provides an excellent example of how industrial organizational changes can impact the overall labor share (Autor et al., 2017). Employer market power has become a fact of life in emerging markets as well (for example, Brandt et al., 2017). In the course of economic development, does the shift in importance of large firms disproportionately favor the adoption of labor-saving technologies (Zhang, 2013)? Or do they, in fact, value worker morale and pay higher wages (Basu, Chau, and Soundararajan, 2018)? These are critical questions that can inform a host of policy issues going forward, from the desirability of minimum wages to facilitate better wage bargains to be struck for workers, to the use of competition policies as a tool for economic development, for example.

Compounding these shifts in technologies and industrial organization, labor market institutions in emerging markets have also seen significant developments. Present-day labor contracts no longer resemble the textbook single employer single worker setting that forms the basis for many policy prescriptions. Instead, workers often confront wage bargains constrained by fixed-term, or temporary contracts. Alternatively, labor contracts are increasingly mired in the ambiguities created in multi-employer relationships, where workers must answer to their factory supervisors in addition to layers of middleman subcontractors. These developments have created wage inequities within establishments, where fixed-term and subcontracted workers face a significant wage discount relative to regular workers, with little access to non-wage benefits. Strikingly, rising employment opportunities can now generate little or even negative wage gains, as the contractual composition of workers changes with employment growth. The result can be a downward spiral in worker morale (Basu, Chau, and Soundararajan, 2018). These developments suggest that a decline in labor share generated by contractual shifts in the labor market can ultimately have adverse consequences on the pace of overall economic progress. Attempts to address wage inequities between workers within establishments is a nascent research area (Freeman, 2014; Basu, Chau, and Soundararajan, 2018), and what is intriguing here is the possibility that we now have a set of circumstances under which inequality mitigating policies, by raising worker morale, may end up improving overall efficiency as well.

The ascendence of superstar firms with a propensity to adopt labor-saving technologies provides an excellent example of how industrial organizational changes can impact labor's overall share of the GNP

We began this chapter by emphasizing the joint importance of overall economic progress and income inequality as metrics of development. Our brief look at the future of the economic development landscape sheds light on the critical importance of bringing together multiple perspectives in our understanding of how these two metrics of development are codetermined. Doing so opens up new policy tools (for example, competition policies and technology policies), new reasons for (non-)intervention (for example, workers' morale consequences of wage inequities), and, perhaps equally important, new policy settings where equity and efficiency are no longer substitutes for each other.

Conclusion

Looking back over the past seven decades since the end of World War II, economic development presents us with a string of contradictions. There have been unprecedented rises in per capita income, with many large developing countries crossing the threshold from low-income to middle-income status. These income increases have been accompanied by equally unprecedented improvements in income poverty and in education and health indicators.

But at the same time there is palpable anxiety about the development process, its sustainability, and its implications for the global economy. Despite the fast increases in income in poorer countries, gaps between them and rich countries remain large. Together with conflict and environmental stress, this has led to migration pressures, particularly for richer countries but also for better-off developing countries. The combination of migration pressures and

Moments before Apple announces a product at its new headquarters in Cupertino, California, on September 12, 2018, just one year after launching its iPhone X, the most expensive smartphone on the market rising inequality has led to the toxic rise of illiberal populist politics which is threatening postwar democratic gains.

While environmental and climate change, and rising inequality in general, have been much discussed, we have highlighted a particular source of rising inequality as an ongoing threat to economic development. The falling share of labor in the economy is set to continue and unless counteracted by strong policy measures will threaten inclusive development in the coming decades.

We have also highlighted how thinking in economics has responded to the underlying forces of change. There has been a broadening of the concept of development beyond the narrowly economic. The roots of the great financial crisis of the end of the first decade of the new millennium have also been scrutinized and, hopefully, some lessons have been learned. And attention is turning to understanding the inexorable decline in labor's share. Whether all this adds up to a New Enlightenment in economic thinking is something the next decades of development will reveal.

Notes

1. This section draws heavily on data and sources referenced in Chapter 1 of Fleurbaey et al. (2018).
2. Our discussion of the literature on the global labor share decline is necessarily selective here. See Grossman et al. (2017) for a notable counterpoint where a global productivity slowdown in the presence of capital and skill complementarity and endogenous human capital accumulation can also give rise to a global decline in the labor share.

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