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Persistent fallacies [1]

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I have been Acemoglu and Robinson's insightful new book *Why Nations Fail* [3]. One section in particular struck me. In one chapter of the book, they talk about why economic growth cannot be sustainable under a set of extractive political institutions. They discuss the case of Soviet Russia and emphasize how their rapid growth during the 1950s and 60s was unsustainable since it wasn't supported by economic dynamism or innovation, *i.e.,* there were no forces of creative destruction.

They managed to achieve growth simply by reallocating a huge number of people from under-productive agriculture into industry. It was only natural that rapid growth would follow since productive resources (labour and capital) could now be used in a much more efficient way, and close to full capacity. However, when this reallocation ran out of steam (70s and 80s), a collapse was imminent.

What was surprising was that a large group of academics, policymakers and intellectuals in the West were mesmerized by this astonishing growth. In fact, many people believed in the 1960s that it was a matter of time before Russia would overtake the USA in its economic and global power. In fact, the argument was that not only do the Soviets grow faster, they manage to do that under full employment and a society based on altruism instead of individualism (and apparently better ethical values).

Sound familiar?

Now, I was aware of all of that, but this I didn't know:

> *"...the most widely used university textbook in economics, written by Nobel-prize winner Paul Samuelson, repeatedly predicted the coming economic dominance of the Soviet Union. In the 1961 edition, Samuelson predicted that the Soviet national income would overtake that of the United States possibly by 1984, but probably by 1997. In the 1980 edition there was little change in the analysis, though the two dates were delayed to 2002 and 2012."*Acemoglu and Robinson (2012) "Why Nations Fail", pp. 128.

In fact, during the years Samuelson predicted the Soviet Union would overtake the US, Russia went bankrupt twice(!). It has returned to a system of extractive political institutions which have again been able to produce some growth and improve living standards based on rising oil and gas prices during the 2000s. But, as the West is again beginning to realize, this is unsustainable. As soon as Russia starts experiencing a twin deficit [4] and when its growth stops being driven by booms in energy prices (as production in the rest of the world increases to meet demand), it is doomed.

However, many pundits believe that China's own "miracle" will continue indefinitely. But, as the authors of the book clearly emphasize in their final chapter, China's growth now is as unsustainable as Russia's was

during the mid-20th Century.

Both are based on extractive political systems which can only achieve temporary growth via reallocation of resources, rather than technological advancements or creative destruction. As long as China?s leaders oppose political freedom and continuing with their anti-entrepreneurial agenda, censorship of the media and technological growth based on adoption rather than innovation, their growth will be unsustainable.

No matter how big the advantages of its supply chain economy or its competitive labour force, this won't be enough to prevent a gradual decline in the many decades to come. I just wonder how long it will take for more Western pundits to realize this.

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