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Book review

## Barriers to Riches

**Stephen L. Parente and Edward C. Prescott, Cambridge, MA, MIT Press, 2000. ISBN 0-262-16193-1, 164 pp.**

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## Article Outline

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This is an important book that should be required reading for development economists. Rather than focusing on the sources of differences in growth rates of per capita income that are the focus of estimates in cross-country convergence regressions, the authors concentrate on explaining variation in levels of per capita income. Though there have been a number of articles on this question in the last several years, this volume is the most thorough effort to date, placing relevant facts and conjectures in a general equilibrium framework.

The authors initially try to explain differences in income per capita levels within a conventional production theoretic framework. They begin with the equilibrium level of

barriers to very low levels, firms entering and exiting industries over time did not have greatly different TFP levels and the productivity gains from such turnover were low. Moreover, firms continuing in business did not have particularly high levels of TFP, though there were no barriers to entry and new equipment could be freely imported. Despite economic liberalization that was much more thorough than that in say Korea and Taiwan, Chile has not had comparable performance, most likely due to the absence of a set of institutions that can foster the productive assimilation of new technology. Reduced barriers to adoption are important, as the authors claim, but they are not sufficient conditions for high productivity.

More generally, the volume treats the national economy as a representative manufacturing plant. For example, the emphasis on work practices stems from some examples of the problems encountered by firms in the Indian textile sector. In Chile and the Philippines, where there has been less protection of union rights, TFP levels are not high. On the other hand, in several of the rapidly growing Asian countries such as Korea and Taiwan, there were significant tariffs and other forms of protection during the first 20–25 years of accelerated growth that gave monopoly rights to existing firms or those created by the state. In Korea, POSCO, a state-owned enterprise, became the most efficient steel producer in the world and several state-owned enterprises in Taiwan became efficient. Similarly, in Japan, much of the rapid growth noted by the authors and whose parameters are used to calibrate one model, occurred under government protection and subsidization of oligopolistic industries. Japan and Korea, and to a smaller extent, Taiwan, actively discourage direct foreign investment. Monopoly rights in these countries have been consistent with the realization of fairly high levels of productivity.

But scaling up a manufacturing firm to the national level ignores the more general requisites for high performance: competent microeconomic policy, a strong institutional structure including a sophisticated (and well-regulated financial system), a national innovation system that facilitates appropriate training and technology absorption, and a competent and honest government. Deficiencies in any of these dimensions can result in a deviation of actual from potential output. The presence of most of the requirements leads to a high ratio of actual to potential output (ignoring cyclical factors) in the OECD countries, whereas their absence guarantees a low ratio and hence low measured TFP.

None of these is to understate the importance of this volume in providing a comprehensive and rigorous examination of how much a pure production-based theory can explain differences in income levels. In doing so the authors have provided a systematic view of the implications of a considerable empirical literature and utilized it thoughtfully. They have provided a major step in addressing the sources of income differences. The difficulty is that the factors omitted (such as the national innovation system) are not analytically tractable in their microeconomic models while macroeconomic policies require a different framework. In the meantime, this is a very useful volume that provides a template and point of departure for thinking about the extraordinary large observed variations in TFP levels, a critical issue for developing countries.

## References

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