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TOPIC 14: GROWTH AND DEVELOPMENT

I. Economic levels

a. There's actually been a fair amount of progress over the past few decades, so much that we should stop thinking about "rich" vs "poor" countries. There are many countries that have lower incomes than the U.S. or Europe but these countries are markedly better off than they were a few decades ago.

b. Instead, development expert Hans Rosling encouraged us to think in terms of "levels" of development based on how much income the average person spends.

i. Level 1: low income (about 1 billion people are here)

ii. Level 2: lower middle income (about 3 billion people are here)

iii. Level 3: upper middle income (about 3 billion people are here)

iv. Level 4: high income (about 1 billion people are here)

c. When people think of development, they often think in terms of level 1 vs level 4 but most people are in between and there's a big difference between level 1 and level 2.

i. The World Bank now organizes countries along these levels for those curious where a particular country lands.

d. Keep in mind that two seemingly contradictory ideas about economic development are true.

i. *The world is getting richer.* Less than $2/day used to be the rule in the 1960s. Now it is the exception. The vast majority of people live lives better than their parents or grandparents and it's wrong to discount that success.

ii. *The world is still "poor*." When plurality of people live in level 2, that's better than living in level 1 but there's still a lot of room for growth. Going from extreme poverty to just poverty is nice but it's still poverty. We want everyone to be in level 4. The question is: how?

II. The Good News

a. The good news is that it does not have to be this way.

i. Economic growth solves most of the problems of the developing world. Greater material wealth can pay for better roads, sanitation, electricity, education, and so on.

    ii. South Korea is a good example of this. In the 1950s, it was an incredibly poor country. Now it is one of the wealthiest countries in the world (with incomes comparable to that of the average of the European Union).

b. Growth is not a *zero-sum game*: if one group becomes wealthier, other groups don't have to become poorer.
    i. This is because long term growth comes from greater efficiency, primarily through technology and other ideas, not from reallocation.
    ii. Because it's not a zero-sum game, we want all economies (both rich and poor) to grow. Growth, like trade, is a *positive sum game*.
    iii. But we'd also like stable growth. Long run growth is great, but that's in the long run. In the meantime, people would like to keep their jobs and live lives stable enough so they can plan.
    iv. Uncertainty is misery, too.
c. Not only is growth not a zero-sum game, we don't need a lot of growth to make a big difference.
    i. *Rule of 70*—remember this? The number of time periods it requires to double a value roughly equals 70 divided by how fast it's growing.
    ii. Suppose an economy's GDP grows at 7% a year. That means it takes (70/7=10) 10 years for the GDP to double.
    iii. China's growth rate in 2016 was 6.7%; India's was 7.1%.
    iv. The US economy grew at 1.6% in 2016; how long would it take our GDP to double at that rate?
d. There's yet more good news: poor countries have an easier time growing quickly compared to rich countries.
    i. It all boils down to decreasing marginal benefit. The benefit in this case is productivity.
    ii. Labor in rich countries tends to have a lot of capital and thus their workers are quite productive (it's one of the reasons wages are high). Giving them more capital increases their productivity, but not by much.
    iii. But labor in poor countries has little capital and thus cheap labor. Just a small amount of capital creates huge productivity gains. Investment and efficiency follow.
    iv. It's the difference between getting your first laptop and getting your eighth; which makes you more productive?

v. As capital flows into the developing country, wages rise and the marginal productivity of capital falls. Eventually, poor countries catch up to rich countries.
vi. China's the current poster-country of the theory of convergence. Its growth rate has been tremendous but lately wages have been increasing. It's no longer the low hanging fruit of production.
vii. There are other examples of countries coming up quickly from very low levels of wealth: Germany and Japan after WWII and South Korea, Hong Kong, Singapore, and Taiwan after the Korean War.

e. So why aren't all countries wealthy? What are the conditions needed for conditional convergence? It's complicated.

III. Origins of Growth

a. Thinking about modern economic growth is best understood thinking about how level IV countries grew. While there's no key idea that triggers growth, institutions play a crucial role.
b. Institutions are typically defined as "the rules of the game," or the rules (often laws) of society. Some definitions extend those rules to include cultural norms.
c. Institutions create incentives that direct human behavior.
   i. "Inclusive" institutions broadly distribute political power and economic opportunities. They make society wealthier because people have the incentive to generate the ideas that create growth.
   ii. "Extractive" institutions focus on taking from locals to empower an elite. As a result, government is either ineffective or (more commonly) accountably to a very narrow group. Such institutions make society poorer.
   iii. What is inclusive for some can be extractive for others. The U.S. allowed for broad political power compared to a monarchy, but that power was extended only to landowning, free, Protestant male adults.
   iv. To square this circle, economists Daron Acemoglu and James A. Robinson argue there is a "narrow corridor to liberty" such that the state is restrained but still functional. Society must be strong enough to limit state power, but not so strong to completely dislodge state power.

d. Important kinds of institutions
    i. Inclusive *economic* institutions cover rules that encourage economic activity. They include clear property rights, openness to trade, well-functioning courts, and flexible labor markets.
    ii. Inclusive *political* institutions cover rules that keep governments accountable. They include freedom of assembly, free speech, free and fair elections, and government transparency.
        1. Again, while limited government is important (such as parliaments that keep a sovereign in check), the government also must be strong enough to secure other institutions (like courts and property rights).
    iii. Inclusive *cultural* institutions cover an expectation of equal treatment and cooperation with strangers. They include base levels of trust in both strangers and government. This is also the hardest kind of institution to change. African countries with a greater history of the slave trade *still* have lower levels of trust.

e. Critically, these institutions interact with one another—for example, high levels of trust make it easier to conduct business and hire people outside your social circle—and they are influenced by other factors.
    i. While resource extraction from colonization didn't make the west rich, it certainly contributed to many parts of the world being poor. For example, many parts of sub-Saharan Africa were subject to extractive institutions (because malaria and other diseases deterred European settlers), ones that favored strong leaders and forced labor, and the stain of that inhumanity influences the continent today.
    ii. Geographical factors also matter. For example, Europe is a peninsula of peninsulas that lent itself to creating several smallish states of similar size. European rulers were thus relatively weak (compared to, say, China) and had give up more power to elites to maintain their position. This geography also contributed to interstate competition, allowing scientific, political, and economic innovations to escape established interests that were threatened by them.

IV. Resource curse

a. It's tempting to think that natural resources help an economy grow. To a certain extent, that's true—natural resources can easily make some, or even many, people much wealthier, but that does not mean such gains will spread to the entire economy.

b. The *resource curse* describes countries with abundant natural resources with low levels of economic development. Such curses are not inevitable (the U.S., for example, has abundant coal) and there's debate about why the curse occurs.
c. The theory that's most relevant for our conversation is thinking about resources as amplifying pre-existing institutions.
    i. Autocrats need tax revenue to pay off people who help keep them in power. Autocrats that piss off the military or police, for example, tend not to last long.
    ii. To generate that revenue, the need some kind of basic economy, so there's an incentive to develop rudimentary infrastructure, literacy, and health care, even if such things can also give the general public the tools to overthrow you. Plus, it costs money that could go to people who help keep autocrats in power.
    iii. A valuable natural resource provides is a helpful substitute to a basic economy; natural resources are an easy way to get the money autocrats can use to pay off supporters without having to invest much in rebellion-inspiring literacy.
    iv. Thus autocracies become *stronger* due to the presence of a valuable natural resource—they reduce the need for an economy to develop.
d. I include this section on the resource curse because students often point to natural resources as a source of growth and because the curse helps illustrate why adopting growth-loving institutions is hard. Countries with despots want to stay in power but growth-loving reforms threaten their position. Less corruption leads to less money to hand out to cronies. Free speech leads to regime-threatening protests. Competitive markets means angry elites who once controlled a comfortable monopoly. Breaking this cycle is *really hard*.

V. Recommended books.
a. This is a HUGE area in economics and honestly economics' most important topic. We could easily do a whole class on development so I wanted to include some additional reading suggestions for anyone interested, but these readings are ***not*** required.
b. *How the World Became Rich: The Historical Origins of Economic Growth*, by Mark Koyama and Jared Rubin, 2022.
    i. Much of the material of the second half of this lecture came from this book. Strongly recommended.
c. *Factfulness: Ten Reasons We're Wrong About the World--and Why Things Are Better Than You Think*, by Hans Rosling, 2018.

d. *Guns, Germs, and Steel*, by Jared Diamond, 1997.
e. *The Dictator's Handbook: Why Bad Behavior Is Almost Always Good Politics*, by Alastair Smith and Bruce Bueno de Mesquita, 2011.