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ECON 201—Montgomery College

LECTURE 21: GROWTH AND DEVELOPMENT I

I. 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, not from reallocation.
    ii. Because it's not a zero-sum game, we want all economies (both rich and poor) to grow.
    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 equally wealthy? That leads us to…

II. The Bad News

a. We'll discuss that next class.