

ECONOMIC GROWTH: CONCEPTS AND PATTERNS

EE 462 Development Macroeconomics
Semester 1/2019

Topics

- Divergent Patterns of Economic Growth since 1960
- Factor Accumulation, Productivity Growth, Econ. Growth
- Saving, Investment, & Capital Accumulation
- Sources of Growth Analysis
- Characteristics of Rapidly Growing Countries

Divergent Patterns of Economic Growth since 1960

Group	Ratios of 2009 to 1960 GDP/capita	Avg. Annual Growth Rates (%)	Examples of Countries
Negative growth	0.89 0.98	- 0.23 - 0.24	Madagascar Zambia
Slow growth	1.05 – 2.16	0.01 – 1.58	Senegal, Kenya, Peru, Chad, S.Africa, Philippines
Moderate growth	3.06 – 4.29	2.31 – 3.01	Turkey, Brazil, Chile, Lesotho, Mauritius
Rapid growth	4.55 – 18.94	3.14 – 6.18	India, Egypt, Malaysia, Thailand, Botswana, China
Industrialized	2.6 – 5.13	1.97 – 3.4	UK, US, Canada, Japan

Calculating Future Values

- *Question: why small differences in growth rates can make a big difference in income levels over time?*
- Suppose a country's current income/capita is X_0 , and the growth rate is $r\%$ per year. What will be the income level in year t ?

$$\rightarrow X_t = X_0 \times (1+r)^t$$

- Example: GDP per capita (2005 PPP) in Thailand was 7,794 in 2009. If the average growth rate is 5% per year, what would be Thailand's GDP per capita GDP in 2019?

$$\rightarrow \text{GDP}_{2019} =$$

$$\rightarrow \text{GDP}_{2019} / \text{GDP}_{2009} =$$

- If $r = 7\%$, $X_{10} = ?$

Calculating Growth Rates

- Suppose a country's current income/capita is X_0 , and the income level in year X_t ?. What's the annual average growth rate? (Recall: $X_t = X_0 \times (1+r)^t$)

1. Calculate growth rate using the *endpoint data*.

$$\rightarrow r = (X_t / X_0)^{1/t} - 1$$

Ex. $X_0=7,794$ and $X_t=12,695$ $\rightarrow r =$

2. Estimate average growth rate by *least-square regression*.

➤ $\ln X_t = \ln X_0 + \ln(1+r) \times t$

➤ Regression: $\ln X_t = a + bt$ where $a = \ln X_0$ and $b = \ln(1+r)$

$$\rightarrow r = e^b - 1$$

Calculating Growth Rates (Cont'd)

- “The rule of 70” – based on continuous compounding
- Given the exponential function:

$$X_t = X_0 \times e^{rt}$$

- How many does it take for income to double?

➔ Let $X_t = 2$ and $X_0 = 1$.

Then,

- Example: If a country's GDP grows at 2% per year, how many years would its economy double in size?

Factor Accumulation, Productivity Growth, Economic Growth

- Economic growth depends on two processes:

1. *Factor Accumulation*

- Increasing in the size of capital stock and labor force.

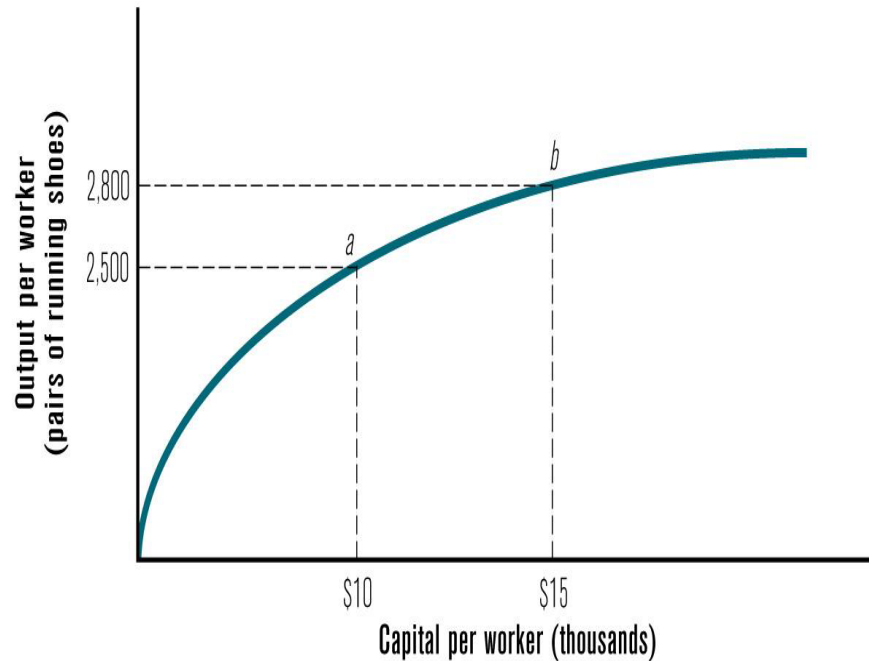
2. *Productivity Growth*

- Increasing the amount of output per unit of machine or worker
- productivity can be increased by greater **efficiency** (e.g. specialization), and **technological change**.

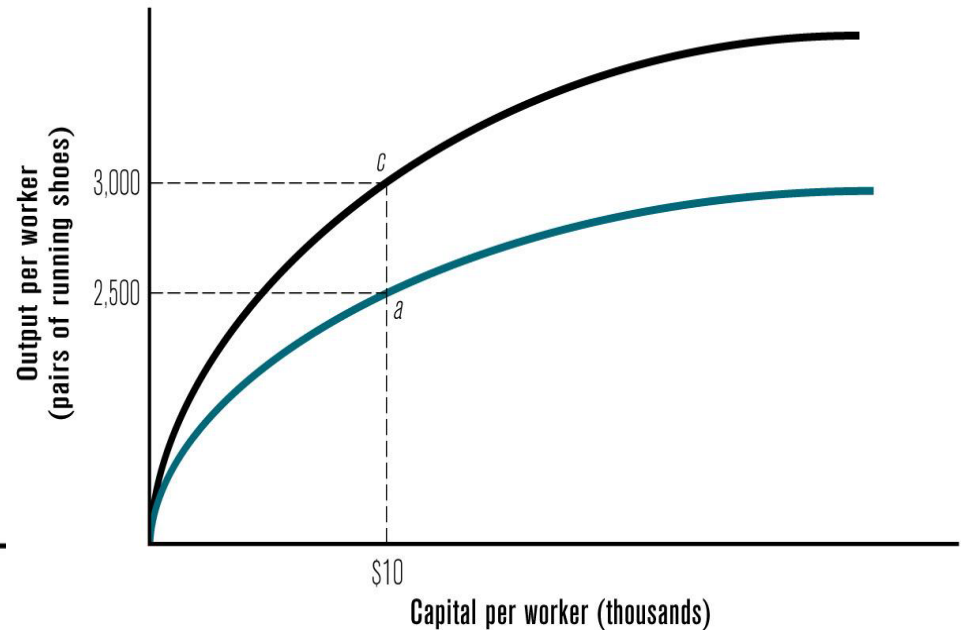
- This can be explained using production function

$$Q = f(\text{Labor, Capital, etc...})$$

Basic Sources of Economic Growth



Factor Accumulation



Productivity Gains

Saving, Investment & Capital Accumulation

- Solow growth model:
 - Explores the contribution of each factor to increase to output: $Q(K, L, \text{Productivity gains})$
- Key elements of economic growth:
 - New investment increases the capital stock
 - Investment (I) is financed through savings (S)
 - Savings comes from current income of GDP: $S = f(Y)$
- *Sustaining Growth requires both generating new investment and making sure it is productive.*

Sources of Growth Analysis

- **Growth accounting** (or **source of growth analysis**) measures the relationship between productivity change and economic growth
- **Total factor productivity (TFP)**: contribution to production of efficiency, technology, and other influences on productivity
- The growth equation can be written as:

$$g_Y = (W_K \times g_K) + (W_N \times g_L) + a$$

where

- g_Y = growth of total income (or GDP)
- g_K, g_L = growth of capital and labor
- W_K, W_N = share of capital and labor
- a = rate of productivity of inputs = “**Solow residual**”

Growth Accounting (Cont'd)

- Example: Assume the following: $g_Y = 0.05$, $g_K = 0.07$, $g_L = 0.02$, $W_L = 0.6$, and $W_K = 0.4$. $a = ?$
 - Recall $g_Y = (W_K \times g_K) + (W_L \times g_L) + a$
 -
- Problems with Solow residual:
 - could represent influences other than productivity gains.
 - “a” captures the measurement errors and omitted variables because it is the residual in the equation.

Sources of Growth: Empirical Evidence

General findings:

- Economic growth in industrialized countries are attributed vastly by TFP, and less by capital accumulation.
- Data problems and price distortions are major concerns in developing countries.
- Sources of econ growth in LDCs attribute a larger role to capital accumulation than in industrialized countries. Why?
- Among developing countries, TFP growth in East Asia was faster than that in other regions.
- TFP growth tends to become more important as income rises.

Sources of Growth Across Countries 1960-2000 (1980s)

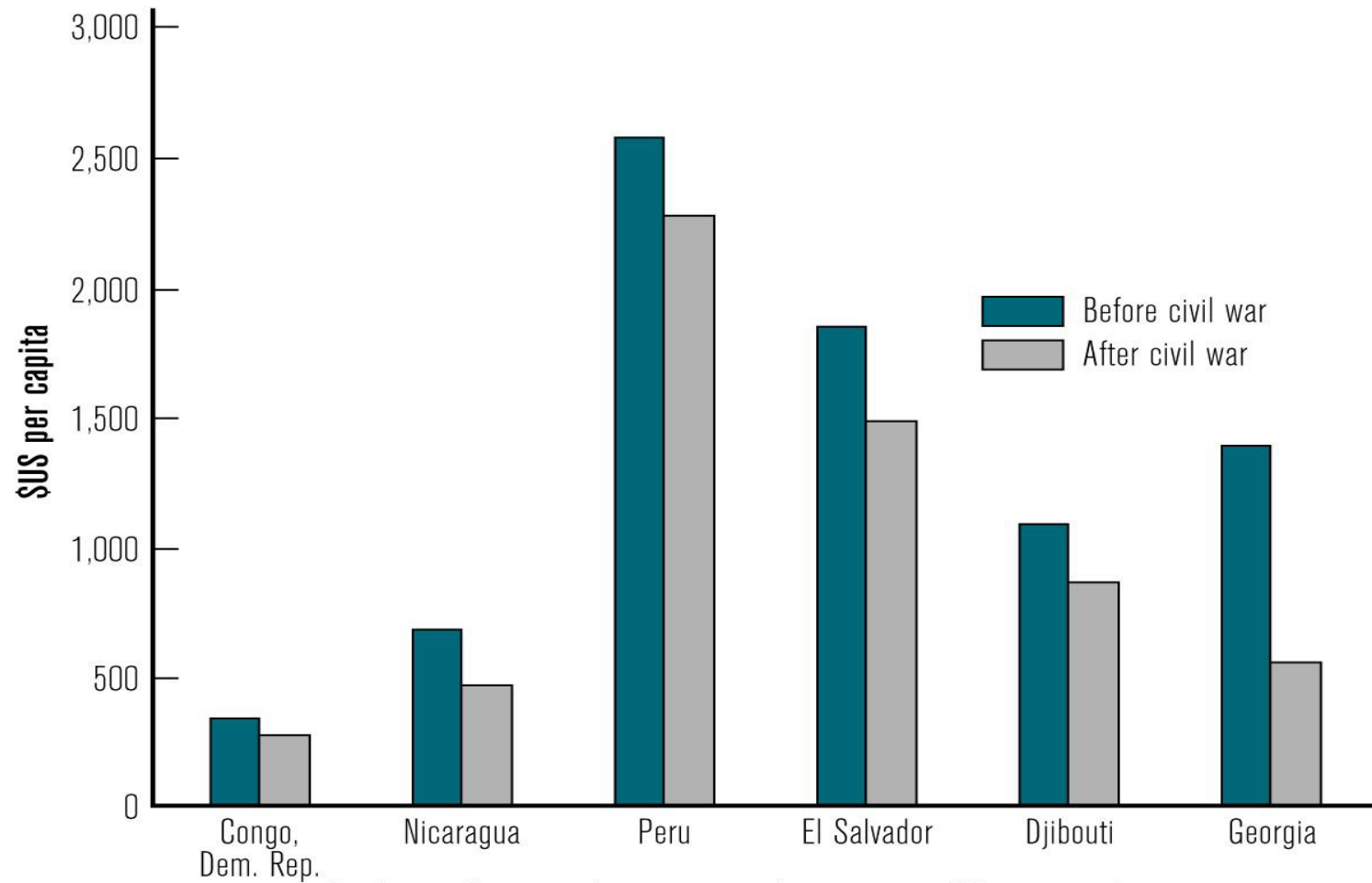
Country/ Region	Growth of Output per worker	Capital per worker	Education per worker	TFP
Brazil	-1.63	0.16	0.68	-2.47
Ethiopia	-1.74	1.11	0.27	-3.12
Ghana	-1.14	-1.23	0.15	0.07
Africa	-1.06	-0.07	0.42	-1.41
East Asia	4.36	2.45	0.66	1.25
Latin America	-1.77	0.04	0.47	-2.28
Middle East	1.15	0.55	0.53	0.07
South Asia	0.68	1.02	0.42	2.25
Industrialized	1.82	0.69	0.24	0.9

Source: Collins & Bosworth (2003). "The Empirics of Growth: An Update."

Characteristics of Rapidly Growing Countries

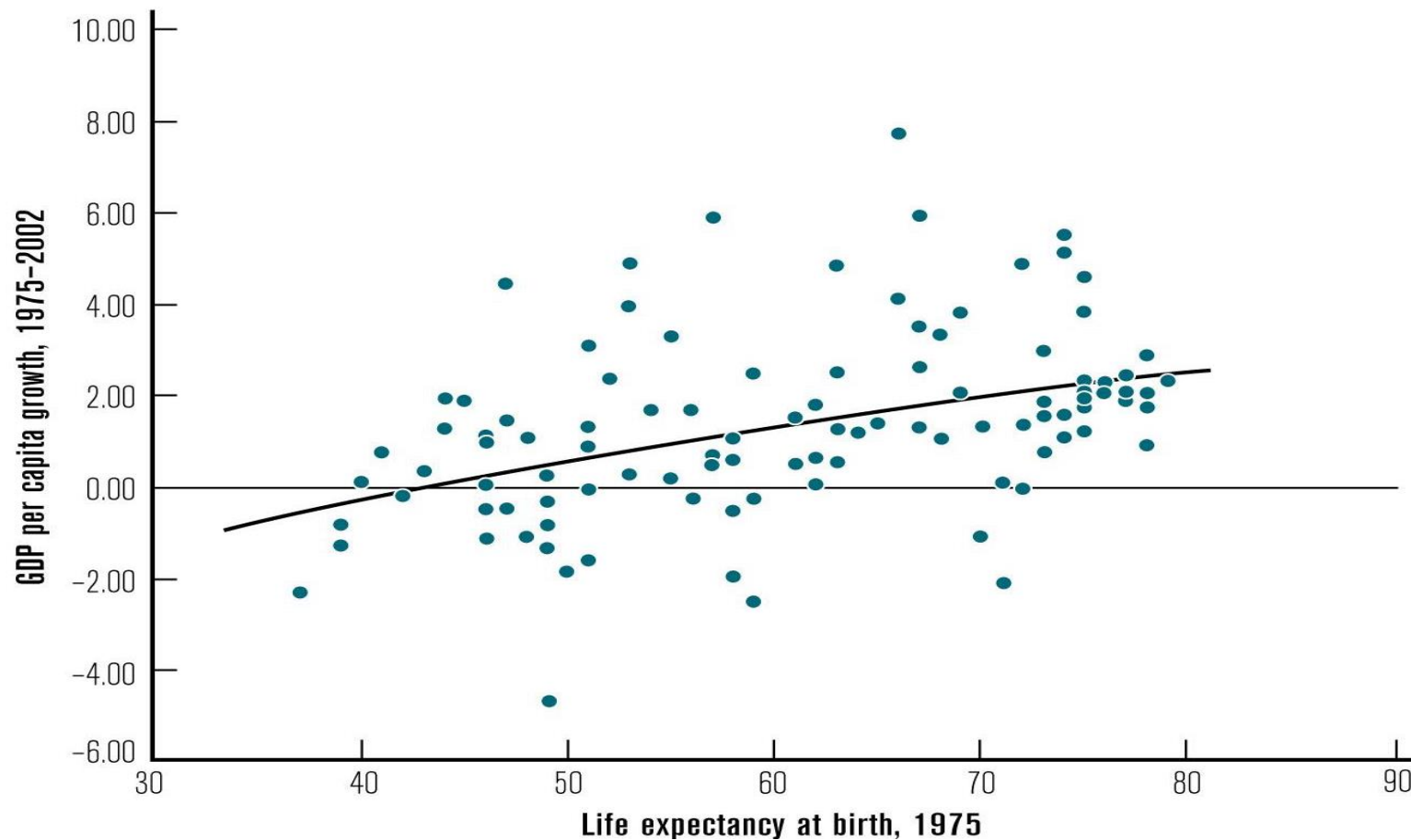
- Why some economies growth faster than others?
 - Need to look at empirical evidence; there's no consensus
 - Important to ask “which causes which?”
- Six broad characteristics that fast-growing countries share:
 1. Macroeconomic stability
 2. Investment in health and education*
 3. Effective governance and institutions
 4. Favorable environment to private enterprise
 5. Trade, openness, and growth*
 6. Favorable geography or location?

GDP per capita before and after a Civil War



➔ Average income was 28% lower after the civil war than before.

Growth and Life Expectancy

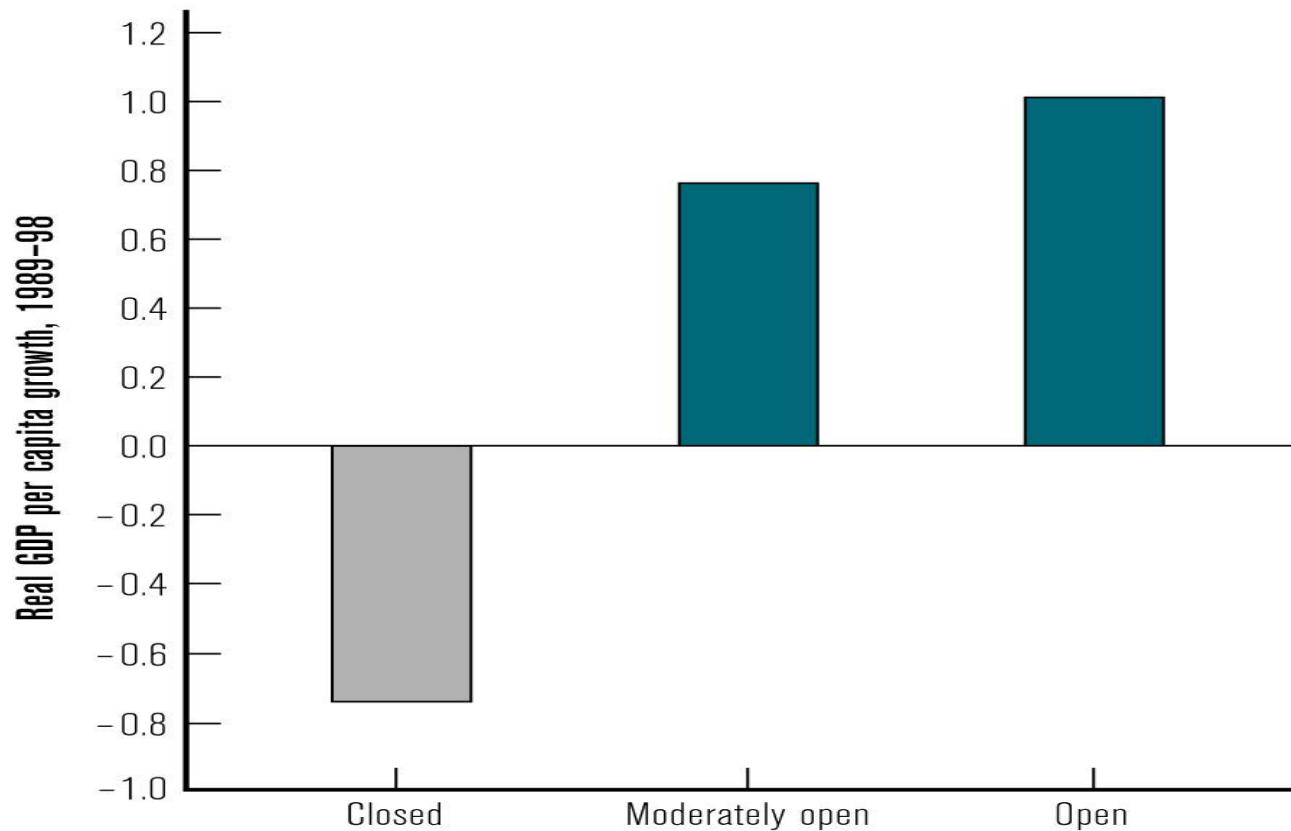


Better health → faster growth OR faster growth (higher income) → improve LE?

Institutions, Governance & Growth [Box 3.2]

- 5 institutions are necessary according to Rodrik and Subramanian (2003):
 1. *Market-creating institutions*: protect property rights
 2. *Market-regulating institutions*: deal with market failures
 3. *Market-stabilizing institutions*: control macroeconomic volatility
 4. *Market-legitimizing institutions*: provide social protection and insurance
 5. *Political institutions*: how a country is governed & extent of political participation

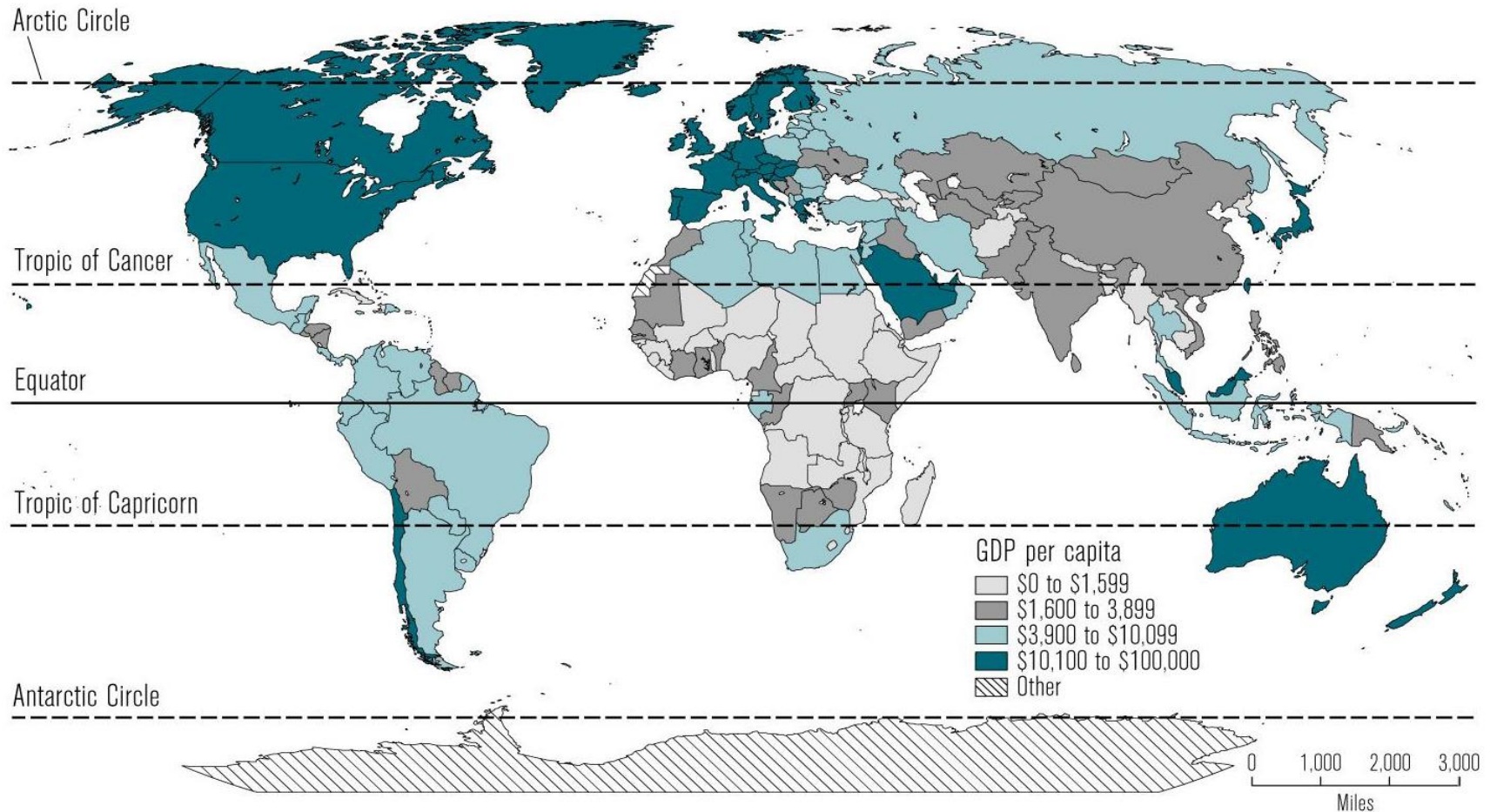
Openness and Growth



Inconclusive evidences:

1. How to construct measure of trade policy orientation
2. Pro-trade policies → growth?

Does geography matter?



More recent data: <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?view=map>