Growth: Theories for Growth

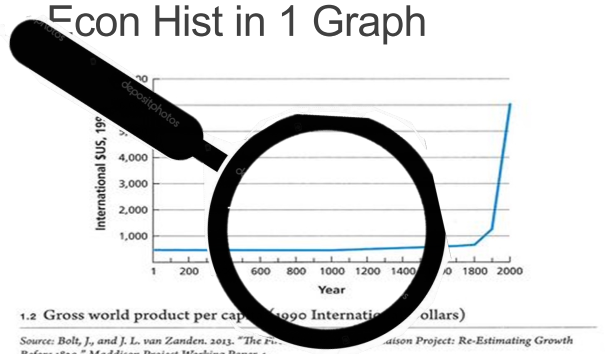
EBH26, LECTURE 2

1

1. A Theory for Growth

2

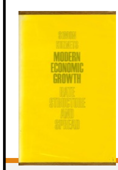
Econ Hist in 1 Graph



3

"Modern Economic Growth": Kuznets Theory

Simon Kuznets, 1901-85



GROWTH CHARACTERISTICS

A. Aggregate growth

1. High rates of increase in per capita product, accompanied by substantial rates of population growth

2. High rates of increase in output per unit of all inputs

B. Structural transformation

3. A high degree of structural transformation, encompassing a shift from agriculture to industry and services

4. Changes in the structure of society and its ideology, including urbanisation and secularisation

C. International spread

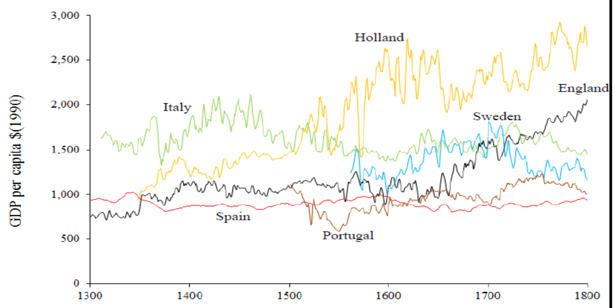
5. Opening up of international communications

6. A growing gap between developed and under-developed nations

4

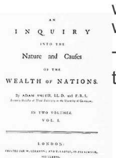
Kuznets "Theory"

- As it is clear, Kuznets provides a description rather than a mechanism
- At best, he provides a "how" MEG unfolded but not "why"
- Kuznets has no explanation and, hence, cannot help us much in the question of why growth started
- For the "why" question, we need to understand first "where"



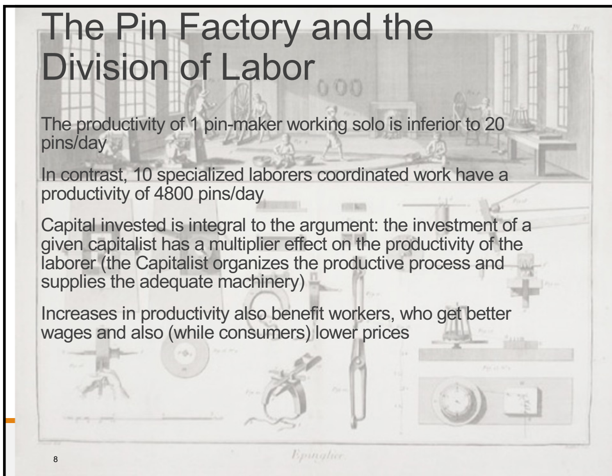
Sources: England (Broadberry et al. 2011); Italy (Malanima 2011); Holland (van Zanden and van Leeuwen 2012); Sweden (Schön and Krantz 2012); Spain (Alvarez-Nogal and Prados de la Escosura 2013); Portugal: (Reis et al. 2013, Palma and Reis 2014). * 3-year average; Spain: 11-year average.

An Inquiry into the nature and causes of the Wealth of Nations (1776)



- The founding book of Economics
- Along with theory, this treatise contains many concrete observations about the major world economies at the time (v.g. China, India, UK, Netherlands, Portugal, Spain, Germany…)
- Its publishing coincides with the period in which Great Britain was experiencing sustained growth (whilst her continental rivals were not)
- The focus of his analysis is not directed at populations or technology, but rather at businesses and their operations

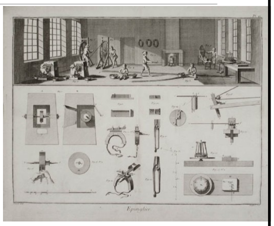
The Pin Factory and the Division of Labor



- The productivity of 1 pin-maker working solo is inferior to 20 pins/day
- In contrast, 10 specialized laborers coordinated work have a productivity of 4800 pins/day
- Capital invested is integral to the argument: the investment of a given capitalist has a multiplier effect on the productivity of the laborer (the Capitalist organizes the productive process and supplies the adequate machinery)
- Increases in productivity also benefit workers, who get better wages and also (while consumers) lower prices

Growth = Growth in Labour Productivity

- Economic growth implies the increase of output per worker (or hour worked)
- The increase in labour productivity is typically the result of more (physical or human) capital per worker)
- Thus, growth is a consequence of more capital per worker (be it technological improvements, better organization or better training)



A 18th-cent. pin factory, Adam Smith's example of how the division of labour multiplied productivity by a very large factor … in the **industrial** sector

Division of Labour (2)

Adam Smith extrapolates the pin factory for an economy as a whole:

- *The separation of different trades and employments from one another, seems to have taken place, in consequence of this advantage.*
- *This separation too is generally carried furthest in those countries which enjoy the highest degree of industry and improvement. The work of one man in a rude state of society [is] that of several in an improved one.*

As such,

- *Wealthiest nations are those in which the division of labour is furthest advanced*

Division of Labour (3)

Adam Smith also remarks that the scope for the specialization of labour is stronger in the industry than in the other sectors:

- *The most opulent nations, indeed, generally excel all their neighbours in agriculture as well as in manufactures; but they are commonly more distinguished by their superiority in the latter than in the former.*
- *Their lands are in general better cultivated, and having more labour and expence bestowed upon them, produce more in proportion to the extent and natural fertility of the ground. But this superiority of produce is seldom much more than in proportion to the superiority of labour and expence.*

AS as good as it gets?

- With Adam Smith (AS), we have a thesis that can be tested.
- In sort, AS claims that, under competition, capital organizes labour and makes it more productive
- This higher productivity benefits the capital-owner, the workers and, through lower prices, the "wealth of nations"
- This is a "natural" (i.e., intrinsic to the human nature) process
- Yet, it seemingly did not occur everywhere, but in a very limited setting (18th cent. GB). Why?