MODULE 19

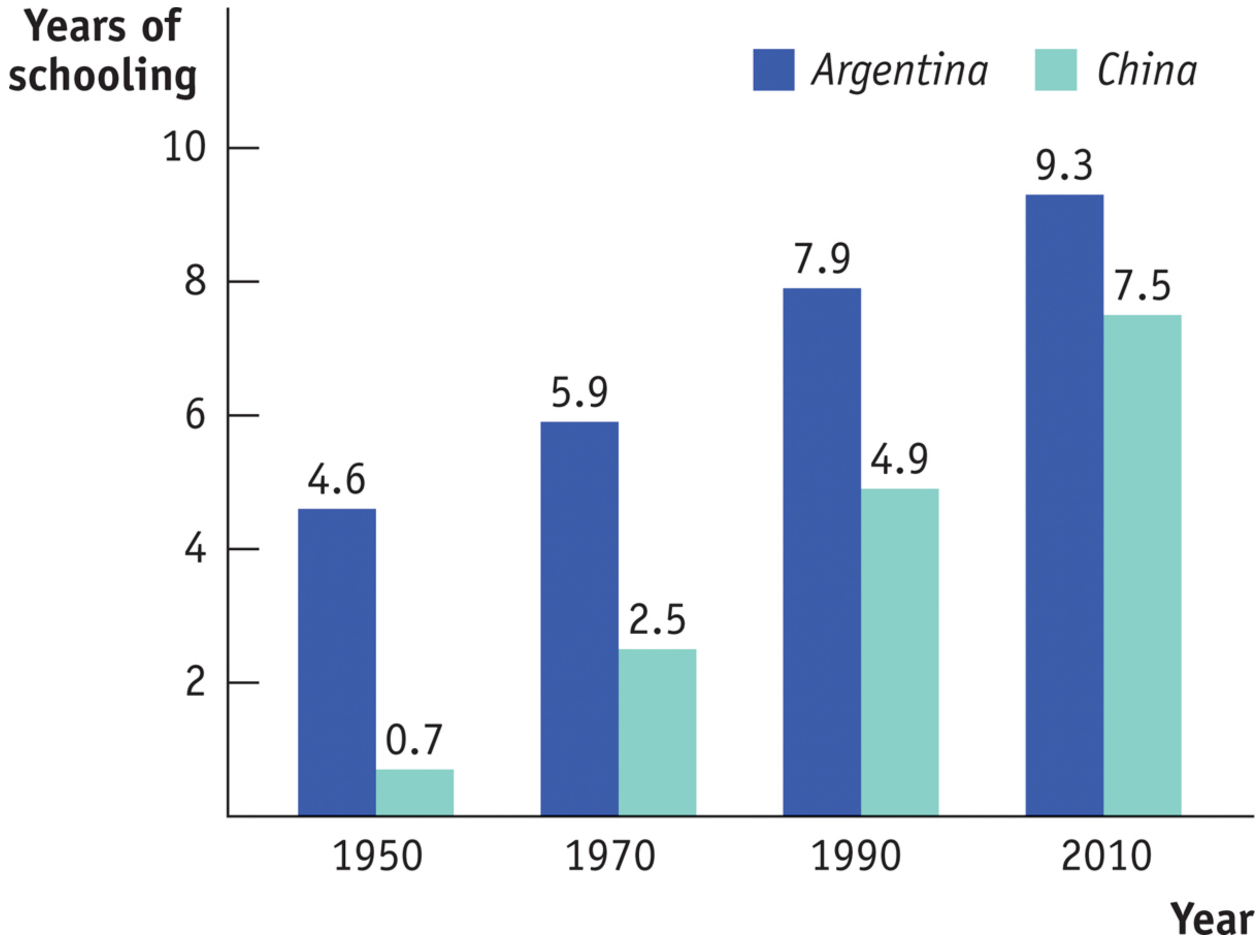
19 Long-Run Growth Policy

Why Growth Rates Differ

- A number of factors influence differences among countries in their growth rates.
- Some countries add to their physical capital more rapidly than others, through high rates of investment spending.
- Some countries add to their human capital through education.
- Some countries engage in or encourage **research and development (R&D)** spending to create new technologies and prepare them for practical use.

Why Growth Rates Differ

China's Students Are Catching Up



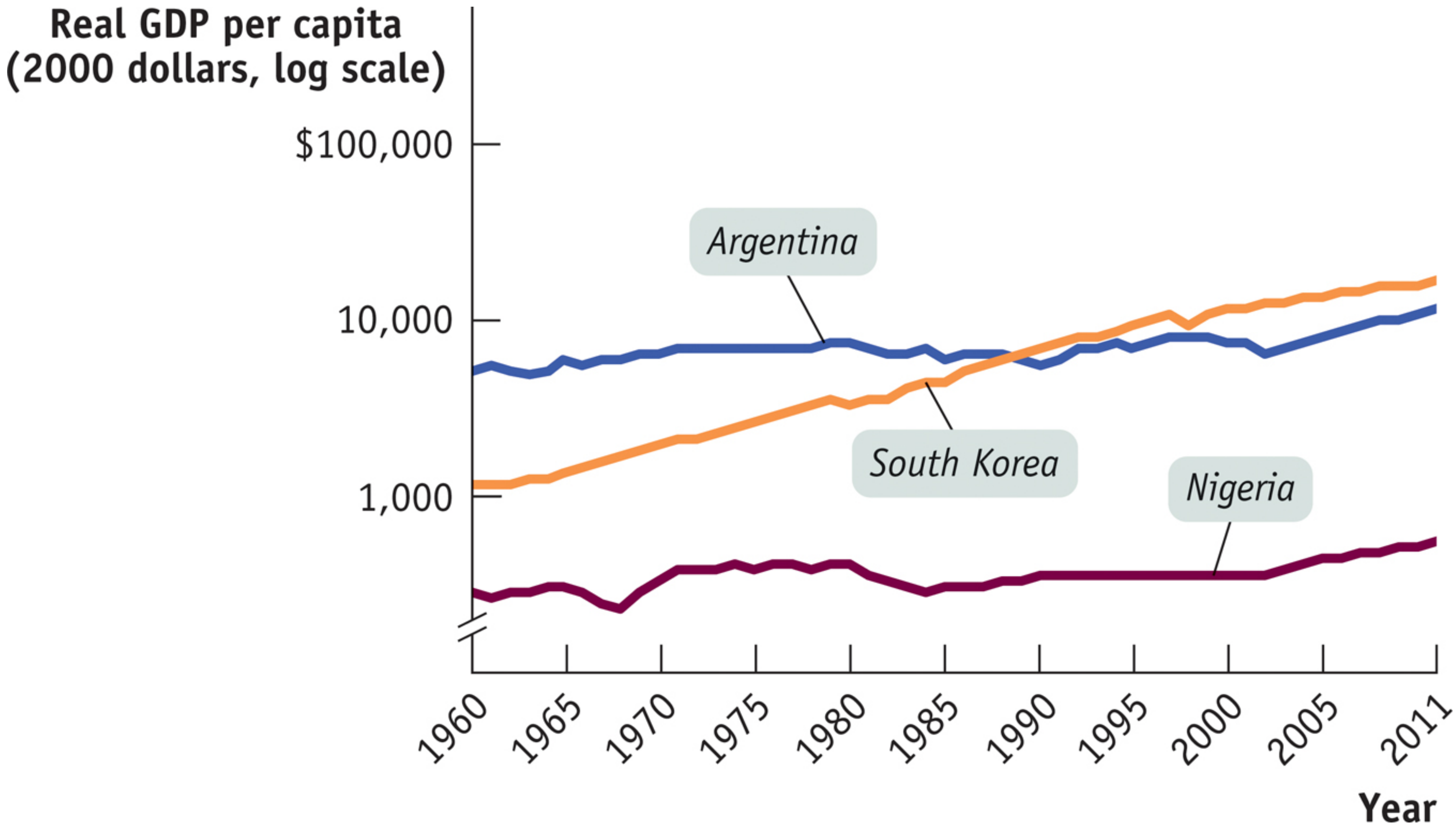
Role of Government in Economic Growth

- Government subsidies to infrastructure such as roads, power lines, ports, information networks, and other parts of an economy’s physical capital
- Government subsidies to education
- Government subsidies to R&D
- Government’s maintenance of a well-functioning financial system
- Government protection of property rights
- Political stability and good governance

Role of Government in Economic Growth

- Even when governments aren’t corrupt, excessive government intervention can slow economic growth.
- If large parts of the economy are supported by government subsidies, protected from imports, or otherwise insulated from competition, productivity tends to suffer because of a lack of incentives.

Success, Disappointment, and Failure



Success, Disappointment, and Failure

- The world economy contains examples of success and failure in achieving long-run economic growth.

- **East Asian** economies have done many things right and achieved very high growth rates.
- In **Latin America**, where some important conditions are lacking, growth has generally been disappointing.
- In **Africa**, real GDP per capita has declined for several decades (there are some signs of progress now).

Success, Disappointment, and Failure

- **East Asia**'s spectacular growth was generated by high savings and investment spending rates, emphasis on education, and adoption of technological advances from other countries.
- Poor education, political instability, and irresponsible government policies are major factors in the slow growth of **Latin America**.
- In **sub-Saharan Africa**, severe instability, war, and poor infrastructure— particularly affecting public health—have resulted in a catastrophic failure of growth.

Success, Disappointment, and Failure

- The growth rates of economically advanced countries have converged, but not the growth rates of countries across the world.

- This has led economists to believe that the **convergence hypothesis** fits the data only when factors that affect growth (i.e. education, infrastructure, and favorable policies and institutions) are held equal across countries.

Economics in Action: Convergence?

Are Economies Converging?

(a) Convergence Among Wealthy Countries . . .

(b) . . . But Not for the World as a Whole