



Economic Development

Michælmas 2013

Solow Model

- Prediction
 - Countries will eventually end up in their steady states.
 - Countries will grow at different rates if they are at different distance from the steady state level
 - (in case they have the same steady state!)

Q: Is there a convergence?

Baumol's Convergence

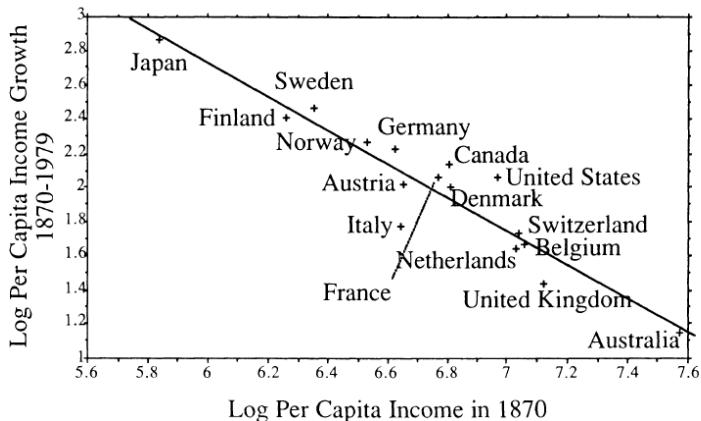
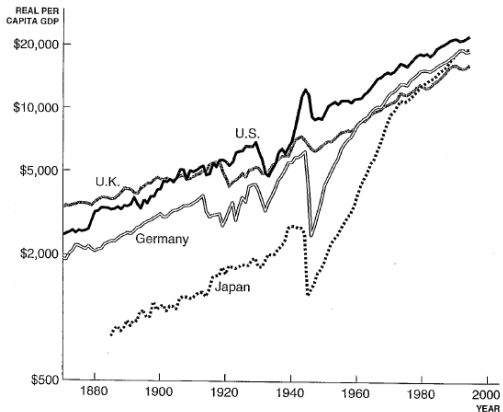


FIGURE 1. PER CAPITA GNP REGRESSION FOR MADDISON'S SIXTEEN

Baumol's Convergence and Delong's Critique



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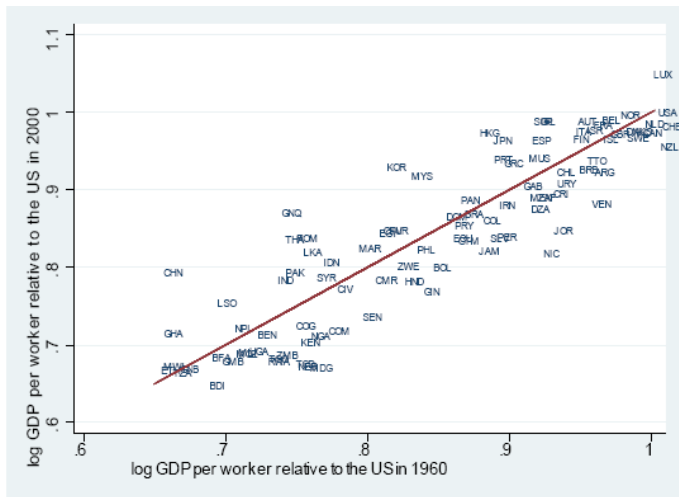
Definition

σ – *convergence* is the catch up effect between countries.

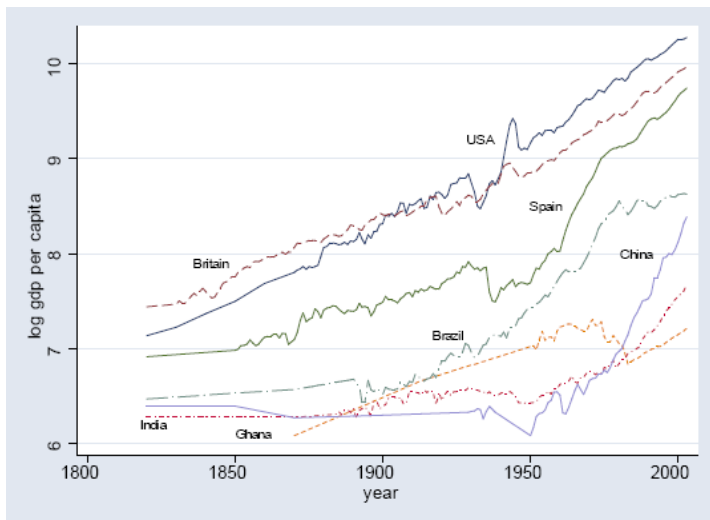
Definition

β – *convergence* (or the conditional convergence) refers to countries converging to their own steady state long run growth rate.

No evidence for absolute (σ) convergence in real data

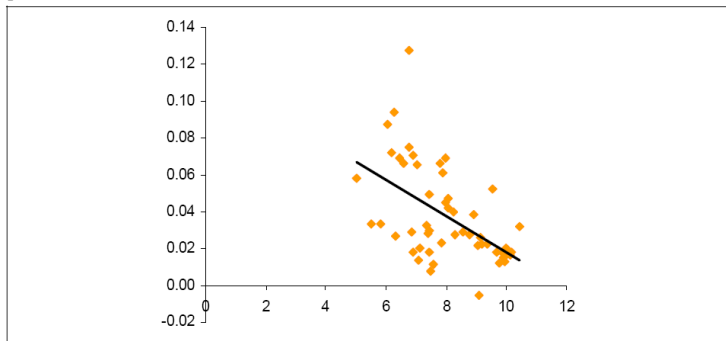


Dubious evidence for conditional (beta) convergence



Strong evidence for conditional (beta) convergence in CEE

Figure 4.2. Testing for β convergence (taking into account adaptation recession in post-communist economies)



Note. OX axis: log of GDP per capita in the initial year; OY axis: average (per capita) growth rate for the selected period (first logarithmic differences).

Source: CASE Network Report 81 (2008)

EU and convergence in CEE

Table: GDP per capita at current PPPs

EU 27 average = 100

	1991	2000	2008	2012
Bulgaria	32	28	40	47
Czech Rep	64	68	80	79
Estonia	40	45	66	70
Hungary	50	56	62	65
Latvia	47	37	53	62
Lithuania	52	39	60	70
Poland	33	48	55	66
Romania	29	26	45	49
Slovakia	42	51	69	75
Slovenia	62	80	92	81
Croatia	44	43	54	61
Macedonia	31	27	35	35
Turkey	27	40	43	56
Russia	55	35	54	70
Portugal	77	78	76	75

Source: Eurostat

Convergence: Proximate and Fundamental Causes of Growth

Major fundamental cause groups:

- luck hypothesis
- geography hypothesis
- institutions hypothesis
- culture hypothesis

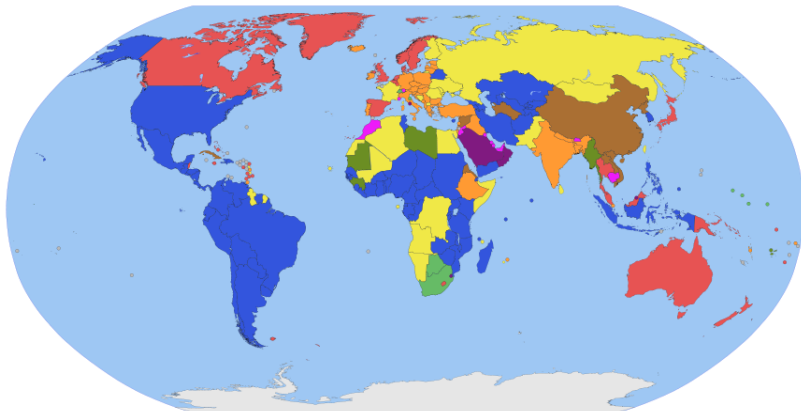


Definition (Government)

The system used for controlling a country

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Governments by type



Role of Government

Adam Smith (1755)

Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes and a tolerable administration of justice; all the rest being brought about by the natural course of things.

Role of Government

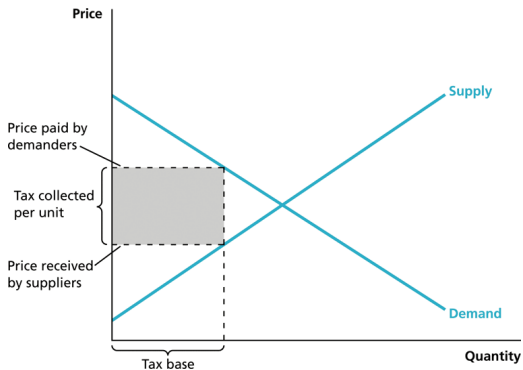
Mancur Olson's theory of state:

- Origins of government
- Roving Bandits vs. Stationary Bandits

Role of Government

- Market failure
 - Property rights and coordination failures
 - ownership, side of driving, production chains
 - Public goods
 - national security, non-excludable and (non-)rivalrous
 - Externalities
 - (Pigouvian) taxes, education,
 - AK model, Centrifugal and centripetal forces
 - Monopolies
- Redistribution (¿Robin Hood?)

Taxation



Quality of Government

- Policy and Governance
 - Good policy and good governance
 - Bad policy and good governance
 - Good policy and bad governance
 - Bad policy and bad governance

Fact (Failed State)

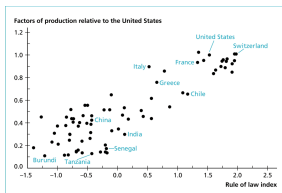
A state in which the government has minimal capacity to pursue policies, or lacks effective authority over a significant part of its internationally recognised territory.

Quality of Government

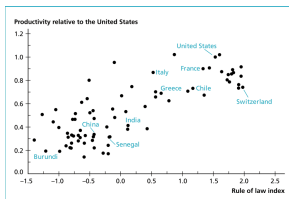
- Corruption
- Kleptocracy
- Self-preservation

Rule of Law

- A public good that does not need (much) taxation
- Effects the economy in myriad ways



Source: Kaufmann, Kraay, and Mastruzzi (2007). Data are scaled to have a standard deviation of 1.



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Competition in Government

Europe vs. China (Zheng He vs. Columbus)

