

Solow Wrap-up

Sources of Economic Growth

A. Resources } Traditional
B. Technology }
Exogenous

Good news:

Growth theory affects human welfare

Growth experts can administer growth

Remember: exogenous

Late 1950s - African Independence

Bad news:

Growth theory affects human welfare

Nations often produce below their production function



Institutions: Significant practices, relationships, or organizations in society

Examples:

Private Property Rights ☺

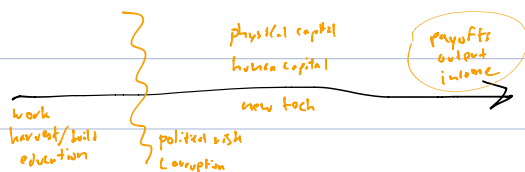
Corruption ☹

Institutions frame the environment within which decisions are made

- Define acceptable behavior
- affect costs and benefits of different actions
- incentives

Three Observations

1. Voluntary investment and production require sacrifice and patience



2. Investment and production occur naturally under certain conditions

Expected Returns > Costs

3. Many factors diminish expected returns

Examples:

- Political Risk
- Corruption
- Inflation Risk
- High Tax Rates

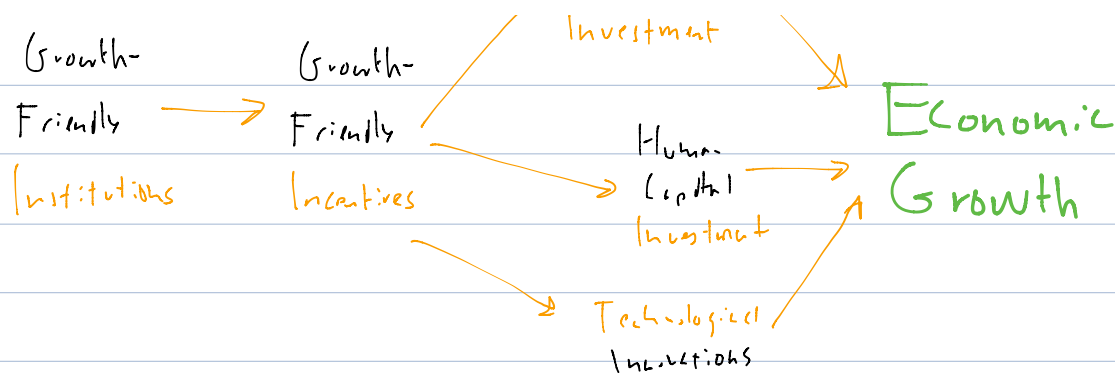
endogenous: having an internal cause or origin

Growth is NOT random

Certain institutions create incentives for endogenous growth

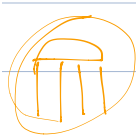
Growth comes from within

Physical
Capital



Institutions that Foster Growth

1. Political Stability and Rule of Law
2. Competitive and Open Markets
 - A. Competitive markets
 - B. International Trade
 - C. Flow of Funds Across Borders
3. Efficient Taxes
 - A. High enough for effective government
 - B. Low enough for profitable production incentives
4. Stable Money and Prices



The three sources of economic growth are
resources, technology, and institutions