

# The Fundamental Causes of Growth and Development

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Lecture Notes for PhD Growth and Development (EC8510)

# From Proximate to Fundamental Causes

- ▶ We have seen that there are substantial differences in prosperity across countries.
- ▶ Even if we can convince ourselves that differences in physical capital, human capital, and productivity explain cross-country differences, this isn't satisfactory.
- ▶ We need to understand why.

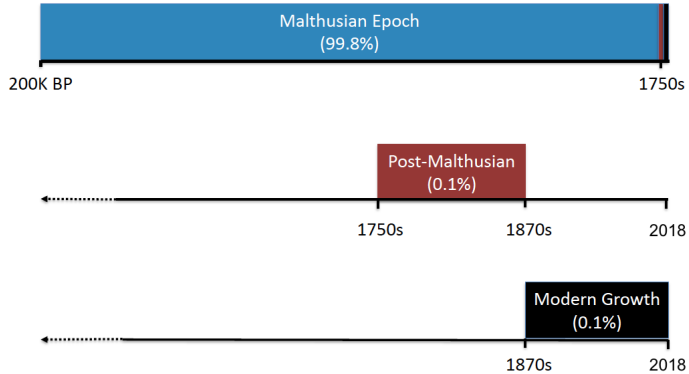
*“... the factors we have listed (innovation, economies of scale, education, capital accumulation, etc.) are not causes of growth; they are growth.”*

– North and Thomas (1973)

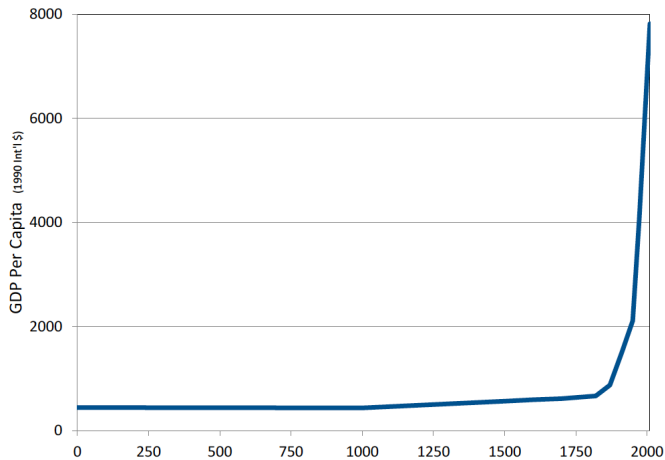
# Why Such Large Differences?

- ▶ The simple answer: growth differences in the past 200 years.
- ▶ Countries that are rich today are those that have grown rapidly between 1800 and 1940.
- ▶ Over the course of human history there has been almost no growth.
- ▶ What accounts for the divergence in per-capita income across countries in the past two centuries?

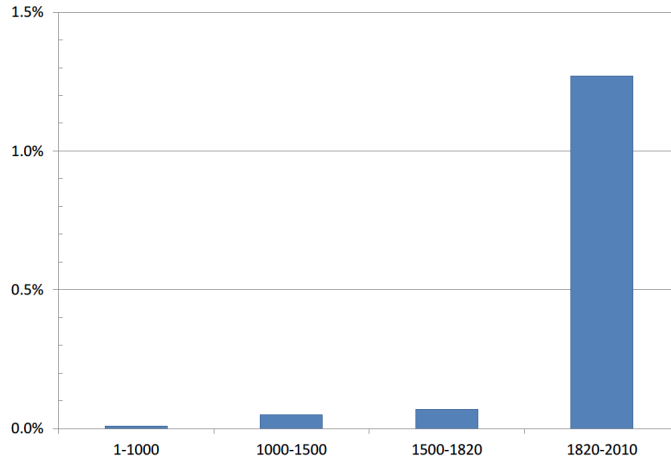
# The Phases of Development



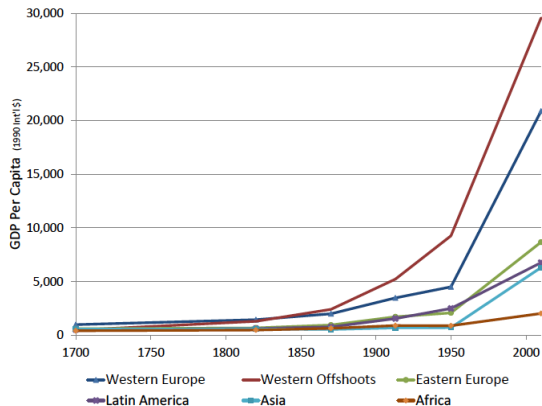
# World Income per Capita (1 - 2100 AD)



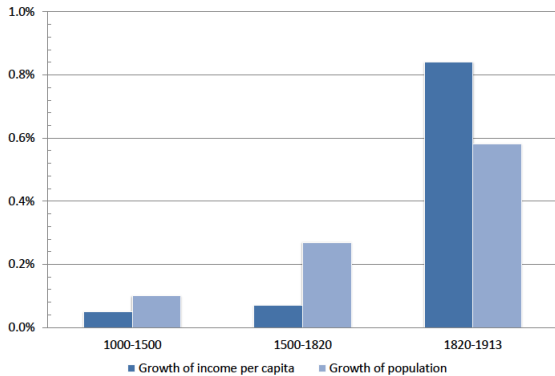
## Growth of World Income per Capita (1 - 2100 AD)



# Regional Variation in the Timing of Take-off

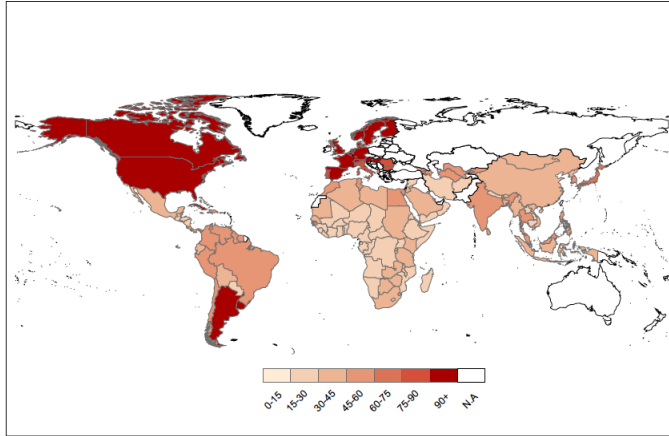


## Take-off: Growth of Population and Income per Capita





# Variation in years elapsed since the Onset of the Demographic Transition



# Potential Fundamental Causes of Growth and Development

- ▶ **Luck:** multiple equilibria lead to divergent paths among societies with identical opportunities, preferences, and market structures.
- ▶ **Institutions:** humanly-devised rules shape the incentives that people face for accumulation, trade, and investment.
- ▶ **Geography:** Exogenous differences in the environment influence agricultural productivity, natural resources, constraints on behavior, etc.
- ▶ **Culture:** Differences in beliefs, attitudes, and preferences.

# The Luck Hypothesis

- ▶ Otherwise-identical countries made different choices that had far-reaching consequences.
- ▶ Or different selection among multiple equilibria
- ▶ Luck and multiple equilibria could be manifest through any of the proximate causes.
- ▶ E.g. Multiple equilibria in technology adoption.
- ▶ Theoretical foundation but questions of empirical plausibility.

# The Geography Hypothesis

- ▶ All factors that are imposed on individuals as part of the physical, geographic, and ecological environment.
- ▶ Can affect growth through all the proximate causes.
- ▶ Examples,
  - ▶ Soil quality can affect agricultural productivity.
  - ▶ Natural resources directly contribute to wealth and as inputs into production.
  - ▶ Climate can affect productivity, health, capital accumulation, and preferences.
  - ▶ Topography affects the cost of transportation and communication.
  - ▶ The disease environment affects health, productivity, and incentives for accumulation.

# The Institutions Hypothesis

- ▶ The rules, regulations, laws, and policies that affect economic incentives.
- ▶ Institutions shape rewards and so are important for all the proximate causes.
- ▶ Institutions reflect social choices, unlike geography and luck.
- ▶ If the members of society collectively decide to change them, they can change them.
- ▶ If institutions matter, reform can lead to better outcomes.

# The Culture Hypothesis

- ▶ Beliefs, values, and preferences shape economic behavior.
- ▶ E.g. differences in religious beliefs, or differences in preferences, such as how important wealth is or how patient individuals should be.
- ▶ Can affect willingness to trade-off different activities, affecting occupational choices, market structure, savings rates, and willingness to accumulate physical and human capital.
- ▶ Can affect the degree of cooperation between individuals, which can be important in underpinning productive activities.
- ▶ Closely related to institutions, but culture is harder to influence, and the suggestion that a society should change its culture vacuous.