



Module:
Macroeconomics

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Macroeconomics

Economic Growth

A brief history of economic growth

- 1 million years ago humans lived as hunter gathers
- A basic subsistence existence
- An economic system that facilitated a very slow and gradual increase in the human population
- Pritchett estimated the subsistence level of income was \$0.68 per day (1990 prices)

A brief history of economic growth

- Between 10,000 and 5,000 BC human race moved towards farming
- Major advance in technology and knowledge
- Livestock – the development of the first financial market?
- Human population around 5mn at this time
- By 10,000 BC human race had already existed for 99% of its total existence on earth

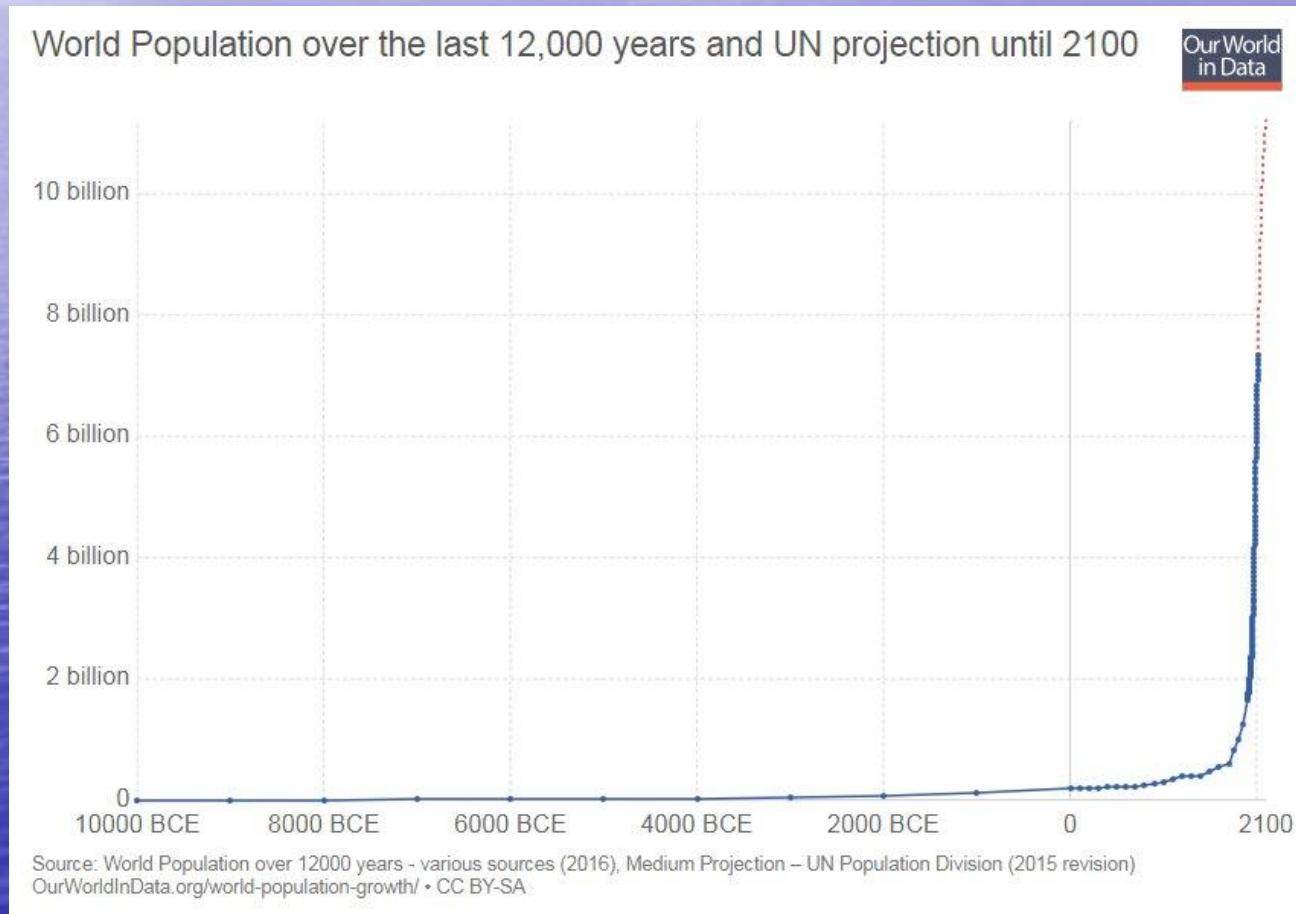
A brief history of economic growth

- By 100BC human population was less than 200m. Most living at or near subsistence level
- Between 0-1500AD there was a very slow increase in income per capita
- Accelerated slightly after 1500
- Took off after 1820

A brief history of economic growth

- Since 1820 real per capita output has grown 8-fold
 - World population has grown 5-fold
 - Total real output has grown 40-fold
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- If human existence were to the scale of a 100 metre sprint. The last 200 years represents the last 2cm of the race

Economic Growth – A Modern Phenomenon



Growth and Human Welfare

- The bottom line for an economy is its ability to satisfy human needs
- The success of an economy is directly related to human welfare
- Economic growth provides better food, clothing, shelter, healthcare and education

Growth and Human Welfare

- The only meaningful way to study economic growth is to focus on how and why individual welfare changes over time
- Economic growth implies growth in human welfare

Productivity

- A country's standard of living depends on its productivity
- **Productivity** - the average quantity of goods & services produced per unit of labor input.
 - Y = real GDP = quantity of output produced
 - L = quantity of labor
 - so productivity = Y/L (output per worker)

Why Productivity Is So Important ?

- When a nation's workers are very productive, real GDP is large and incomes are high.
- When productivity grows rapidly, so do living standards.
- What, then, determines productivity and its growth rate?

Determinants of Economic Growth

- Physical Capital Per Worker
- Human Capital Per Worker
- Natural Resources Per Worker
- Technological Knowledge

Economic Growth & Government Policy

- Saving and Investment
- Investment from Abroad
- Education
- Health and Nutrition
- Free Trade
- Institutions
- Research and Development

What are institutions ?

- Institutions are the wide range of governing structures, formal rules & informal norms, cultures & customs that guide & motivate people's behaviour within complex systems
- Institutions are "...the humanly devised constraints that structure human interaction. They are made up of formal constraints (e.g. rules, laws, constitutions), informal constraints (e.g. norms of behaviour, conventions, self-imposed codes of conduct), & their enforcement characteristics. Together they define the incentive structure of societies & specifically economies" North (1994; 359)

Institutions

- Institutions are the laws, social norms, traditions, religious beliefs & other established rules of behaviour that provide the incentives that rational people react to

Why Nations Fail

- *"Why Nations Fail – The Origins of Power, Prosperity and Poverty"* by Acemoglu & Robinson (2012)
- Institutions determine the fate of nations
- Getting the economics right requires getting the politics right
- See also Institutions Rule: The Primacy of Institutions over Integration and Geography in Economic Development by Rodrik, Subramanian and Trebbi (2004)

Why Nations Fail

- Successful Nations

- Political & economic institutions need to be inclusive and pluralistic
- This creates incentives for everyone to invest in the future
- Inclusive political institutions mean both a broad distribution of political and economic power & limits to that power

Why Nations Fail

- Unsuccessful Nations

- Institutions are “extractive” protecting the political and economic power of only a small elite that takes income from everyone else
- Extractive political institutions support the economic institutions that protect the interests of the elite against new entry from competitors
- Extractive states can have bursts of growth
- But, members of the extractive elite will not allow “creative destruction” to eliminate their own enterprises

Why Nations Fail

- Inclusive & Pluralistic ***political institutions*** feature concepts such as universal suffrage, free & fair democratic elections, separation of powers, written constitutions, a free press, access to the political system
- Inclusive & Pluralistic ***economic institutions*** provide for a strong system of property rights, fair contract enforcement, competitive markets, freedom of citizens to enter professions & industries of their choice, access to good education, bureaucratic efficiency, fair taxes